

SERIOUS MANAGEMENT PROBLEMS IN THE U.S. GOVERNMENT

HEARINGS BEFORE THE **COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE** **ONE HUNDRED FIRST CONGRESS** **FIRST SESSION**

SEPTEMBER 28 AND OCTOBER 3, 5, 1989

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SERIOUS MANAGEMENT PROBLEMS IN THE U.S. GOVERNMENT

THURSDAY, SEPTEMBER 28, 1989

— U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Committee met, pursuant to notice, at 9:30 a.m., in room SD-342, Dirksen Senate Office Building, Hon. John Glenn, Chairman of the Committee, presiding.

Present: Senators Glenn, Levin, Kohl, and Roth.

OPENING STATEMENT OF CHAIRMAN GLENN

Chairman GLENN. The Committee will come to order.

Over the past few years, we have encountered a number of serious problems which have afflicted the programs, the management and the operations of the Federal Government. These include, but certainly are not limited to, the Ill-Wind procurement scandal at the Department of Defense; the influence peddling scandal at the Department of Housing and Urban Development; the huge environment, safety and health problems at the Department of Energy's nuclear weapons facilities which this Committee helped expose; the quality control and management problems at NASA that were revealed in the aftermath of the Challenger explosion; the lack of institutional controls which permitted something like the Iran-Contra operation to occur; and the scandals affecting the savings and loan industry.

Now, these are all large ones that have been prominent in the news media. However, I am sure there are many other much smaller items which are being improperly monitored, and, when all are put together, make some of these big single items look small by comparison.

Basically, these crises and scandals have left us a legacy of broken promises and broken budgets. At the core of each of the disasters just enumerated is a huge failure on the part of the prior administration, for one, and, in some instances, the failure on the part of this Congress and prior Congresses to properly and honestly address such problems before they became so critical.

The HUD scandal that has been developing over several years in the last administration has obviously shown the need for better and for more comprehensive oversight of the Executive Branch by all congressional committees, including this one. I see many of us as having been derelict in not paying more attention to some of the reports we got that should have triggered off our interest and

might have prevented some of these things from getting as large as they came to be.

So, it is a challenge that we cannot ignore, and today we begin a series of hearings designed to expose a number of serious management problems in our government agencies, problems that must be dealt with if we are not to continue the kind of scandals that have already come to light.

This Committee was instrumental in putting into place the IG Act back in 1978. We improved it by adding some new agencies last year. We put it in first as, admittedly, an experiment. We did not know, really, whether it would do that much good or not, but I think it has been very successful, so much so that, as I said, we did expand it last year. It has been one of our government success stories little noted in the press. Some of the testimony today will not be as eye-catching, perhaps, as some of the other things that happen in government, but it is, nonetheless, very, very important if we are to get control of the situation.

Today, we will hear from the Inspector General of the Department of Defense, June Gibbs Brown and DOD Deputy Inspector General Derek J. Vander Schaaf, the Deputy Inspector General; from the Department of Energy, John C. Layton; from the National Aeronautics and Space Administration, Bill D. Colvin; and, finally, from the Department of State, Sherman Funk, who also serves as the Vice Chairman of the President's Council on Integrity and Efficiency (PCIE), which is headed by the Deputy Director of the Office of Management and Budget. These four IG's will relate a number of serious problems that I find deeply disturbing. They will also indicate some of the success stories.

One example, just from the testimony of each IG, illustrates this process. I do not mean to steal their thunder in advance, but I point these things out just to indicate that I hope everyone will take advantage of the statements that they are giving, read them thoroughly, because we will not have time enough this morning, obviously, to go into the kind of detail that we would like to go into on each one, but let me give you some examples.

The core of the Department of Energy IG's testimony is that the contracts by which DOE's nuclear weapons facilities operate are so one-sided in favor of the contractor that, in practice, once money is spent by the contractor, no matter how seemingly outrageous the expenditure, the government will reimburse.

For example, if the contractor unlawfully fouls the environment, the government pays the penalties. Nor can the government require the contractor to fire employees who commit such environmental crimes; and, finally, the government has to pay the contractor to clean up the mess the contractor created.

Now, at least five of these DOE contracts do not even go through the charade of requiring that costs be "reasonable" before reimbursement, despite the fact that DOE has almost no history of determining which costs are "unreasonable," even where such language exists in its contracts. There was never any cost disallowed prior to 1987, as an example.

DOE, of course, operated under secrecy back in those days. The program was hidden for so long that it meant that we also bred into the program the possibility for major abuses which have been

uncovered in recent years. I think Secretary Watkins is making a yeoman-like effort to clean up that whole situation, and we have been working very closely with him.

Ms. Brown, in turn, will describe the DOD IG office's continued concern with DOD management issues, from diversion of weapons and supplies from DOD warehouses to medical fraud, where the government is billed for services which were never delivered.

In addition, Mrs. Brown, who is leaving her office in October, will describe how the Bush administration has handled the review process for retaining or firing the inspectors general at all agencies.

At a PCIE meeting at the beginning of the administration, the IG's were informed by the leadership of the Office of Management and Budget that agency management would be consulted as to the decision to retain or fire them. Many months passed, without outward signs that the individual IG's would be either retained or fired. And while the IG Act states that IG's serve at the pleasure of the President, these actions left all of the IG's in a state of uncertainty, and many IG's still do not know whether they will be retained or fired. At worst, these actions had a chilling effect on inspectors general more concerned with keeping their jobs than being, to use the former President's phrase, "junkyard dogs" in defense of the taxpayers.

So, we invite the attention of the press to all of these things and, in particular, to Ms. Brown's report, to the number of convictions, the charges brought, and the cases in court. The report shows a great success story over there, even though so much more needs to be done.

Based upon the IG's audits, it appears that DOD continues to suffer from the poor quality and lack of investment in the infrastructure of its supply system; the quality of routine spare parts procured by DOD is sometimes poor or questionable, and many other serious concerns exist. We have had some hearings on some of these items in the past.

The Federal Managers Financial Integrity Act requires all agencies to report to this and other congressional committees the material weaknesses in agency operations and the areas that are vulnerable to fraud and waste. In 1985, shortly before the Challenger exploded, NASA indicated it had no such weaknesses. Well, we know by what came out in the investigation afterwards, that the report just was not true. Today, in 1989, Mr. Colvin, the NASA IG, will describe NASA's current inability to adequately oversee its contracting activities, in part because it lacks the staffing to do so. Over 88 percent of NASA's budget goes to procurement. If NASA does not have the staff to oversee this, the potential for fraud, waste and abuse rises accordingly. That becomes particularly acute, as reported under the front page of The New York Times today, when we are doing so much more contracting out now. Because there are fewer civil servants in the government, in NASA in particular, to oversee this huge burden of contracting out, how do you adequately oversee that and make certain that all the checks are run properly?

The IG at the State Department, Mr. Funk, will testify that the State Department IG can no longer investigate crimes such as visa

fraud, which has become a substantial item of investigation, because of a ruling by the Department of Justice limiting the authority of inspectors general throughout the government.

We will hear more about that problem in our next hearing on Tuesday, when the IG's of domestic agencies describe the problems that this Department of Justice ruling causes. Visa fraud can obviously benefit terrorists and other enemies of the United States who utilize the unlawfully obtained visa to travel in Europe among our European allies or elsewhere. So, according to an opinion of some of the IG's that we have talked to so far, this Justice Department opinion is, in their words, wreaking havoc all over the government as IG's are forced to close investigations as a result of these limitations.

So, the goal of this hearing is to take a fresh look at the problems faced by our own key national security and major procurement agencies. Next Tuesday, we will hear from three IG's with responsibility for major domestic agencies: Health and Human Services, the Environmental Protection Agency, and the Department of Labor.

Finally, next Thursday, we will hear from the Office of Management and Budget Director Richard Darman, on what the administration is doing, particularly what OMB is doing, to remedy the serious problems revealed by these hearings. This will be one of our efforts, as we said at Mr. Darman's confirmation hearings, to put the "M" back into OMB, put the follow-up management back into OMB, which he wants to do. We have talked to him about this on a number of occasions, and he says that he wants to do exactly that.

This Committee has put in place many of the tools to fight fraud, waste and abuse. These tools include the 25 statutory IG offices which we have established. But these tools are useless unless the President nominates good candidates for such offices.

Last year, the Congress passed a bill which I introduced to extend the statutory IG Act coverage to a number of agencies including the Department of the Treasury, the Department of Justice, the Office of Personnel Management, and FEMA, Federal Emergency Management Agency. To date, the President has failed to nominate an IG for any of these offices, eight months into this administration.

Last year, the Congress created a new Department of Veterans' Affairs, and today the IG office at the new agency still remains vacant. So, I believe it is time for the administration to address the problems of fraud, waste and abuse by nominating good candidates for these positions, rather than paying lip-service to the goals of government efficiency.

The interviews with the Inspectors General that have resulted in this hearing will be a regular feature of this Committee's exercise of its oversight function from now on. The IG's and this Committee take very seriously the mandate we have given to them of independence and to tell not only their particular departments or agencies what has been determined, but also to let Congress know. And as we shall soon hear, they know a great deal.

That was a rather lengthy opening statement, but I think it is important to set this whole thing in context as to the importance of it. We think that the IG's have been one of the real success stories

that have gotten little attention—a lot of attention in their particular agencies, obviously, when they come up with some of the reports that are critical of the ways things are going, but they have been one of the real success stories. We are proud of what they have done on this Committee and we want to give them support, and that means that we need to listen to what they say and correct these deficiencies before they occur, before they result in disaster, if we possibly can.

Senator Roth?

OPENING STATEMENT OF SENATOR ROTH

Senator ROTH. Thank you, Mr. Chairman.

I appreciate very much the fact that we are having these hearings today. I think they are important, for two reasons: First, from the standpoint of oversight of the agencies represented here today, I shall be interested in hearing each of the inspectors general testify, as required under the law, as to what significant problems, abuses and deficiencies exist relating to the administrations of programs and operations of their agency and what is being done to correct those problems.

Secondly, I am particularly interested in whether or not the system is working. The inspectors general are a product of this Committee, and I know that all of us that were there in the beginning wanted the creation of an independent inspector general primarily to insure that the taxpayer dollar was well spent, that we had adequate financial records to be audited, and the programs were being administered as intended by the Congress.

Now, I am concerned that the system is not working as well as we had intended. Unquestionably, there has been a major step forward, but certainly what has happened at HUD has to give us pause: Why has the system failed? Is it a problem with the Inspector General? Has he provided adequate information to the management, to the Congress?

I want to underscore what the Chairman said a few minutes ago: The Inspector General is responsible for reporting to the Congress, as well as to management. The system seemed to work very well at HUD when you had a Secretary who was concerned. It did not take Jack Kemp very long after he took over to take corrective action. But where was Congress? Was it because they were inadequately notified as to the problems, or was it a lack of oversight?

I would say, Mr. Chairman, that I agree with you and applaud this Committee holding regular oversight hearings, at which the IG appear. But having said that, I would also emphasize that I think it is critically important that the authorization committees discharge their oversight responsibility. Those with the authority to authorize are the ones that should be reviewing to insure that the programs are being properly administered.

Having said that, I do not want to infer any criticism of the past Chairman of Banking, because I think Senator Proxmire was, without question, one of the best watchdogs we had. He made a reputation throughout this country for being a careful guardian, a "junkyard dog," if you want to call it, in protecting the taxpayer money.

But somehow I do not see that the Congress is necessarily discharging its responsibility.

Having said that, let me also point out, having looked at some of these reports—I once was in the Army and I remember my boss, a general, said, "If you can't put it on one page, don't bother, I won't read it," and if that is true of a general, it is even more true of a Senator.

How can we alert—and I say that not critically, because I think time is the biggest problem of the average Senator—how can we alert the Senators of the problems here? So, I am also going to be interested in what the inspectors general have to say about the system, how can we do a better job of alerting Congress when there are problems, not after billions are lost, but early on.

We all know there is going to be a certain amount of problem when we are spending billions—what is it, a trillion dollars we are spending a year—but how can we insure that the tax dollar is being well spent. So, I am going to be very interested, Mr. Chairman, in having their recommendations.

In closing, let me just say one thing that concerns me. Frankly, I think the financial records of this government are in the Middle Ages. For years, the Comptroller General has recommended that we have standard accounting procedures throughout government, and we have never been able to get Congress to act on that. We have different systems, there is no consistency. I am not sure how you can intelligently audit when you do not have some standard practices as to how you keep these accounts.

I also think it is important that we have a financial officer for the government as a whole and for each of the agencies. As a matter of fact, Mr. Chairman, last year, when we created the Veteran's Department, we authorized and required that there be a chief financial officer.

So, these are some of these things I am going to be interested in today, and I want to thank you again, Mr. Chairman, for holding these hearings.

Chairman GLENN. Thank you.

We are working on the followup to that. We will introduce legislation later this year, as we did last year and unfortunately, did not get it through. The GAO, in their initial report, when they looked into this, found that in the number of accounting systems there were 400 different accounting systems in government—400. I do not think I could devise 400 different systems. They are not able to talk to each other quite often on the computers, which is very important these days. They finally revised that and said, well, we have about 200 major differences in the latest one. No company could operate that way and neither can the United States Government operate efficiently, so we are working in that area of a chief financial officer also.

We got into a big argument last year as to where the thing should be located, under Treasury or under OMB or where, and that was one of the things that held it up last year, but we will save that for another day's testimony.

Senator Heinz is unable to be with us today and he has a statement that he would like placed into the record. Without objection the statement will be accepted for the record at this point.

[The statement follows:]

OPENING STATEMENT OF SENATOR HEINZ

Mr. Chairman, I want to thank you for holding this hearing. Today, the Committee will commence a series of hearings examining the soundness and viability of operations performed by Inspector Generals.

As a matter of fact, Mr. Chairman, you will recall that I joined you and others on this Committee as an original cosponsor of legislation establishing five Inspector General offices throughout the Federal government during the 100th Congress. This Senator is interested in determining how we can assist IGs with their day to day activities in an ongoing effort to utilize taxpayer money in the most appropriate and responsive way.

When discussing accountability and credibility in the Federal government, one is reminded of the wisdom found in Federalist 51. The familiar quotation states "If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls on government would be necessary." The Offices of Inspector Generals (OIG) serve as the necessary internal control on the Federal government.

Congress greatly improved the Federal government's internal controls with the enactment of the Inspector General Act in 1978. It serves to strengthen our internal audit and investigative activities in order to obtain greater economy and efficiency within the Federal government. In efforts to uncover and prevent waste, fraud, and abuse Inspector Generals in 59 Federal agencies have proven themselves successful.

For example, estimated savings at the Department of Defense for the five-year period FY 84 through FY 88 totaled approximately \$10.4 billion. This includes investigative recoveries, agency commitments to recover funds, and management commitments to use funds more efficiently.

Efforts by the IGs office at the General Services Administration (GSA) illustrates the important role IGs play in preventing fraud. As a result of an IG preaward audit of a pricing proposal, GSA was able to obtain pricing concessions of nearly \$17.4 million on a contract for automated data processing (ADP) equipment after auditors learned the firm offered commercial customers larger discounts.

The continued success of IGs in finding and preventing fraud and improving government efficiency, however, is predicated upon the independence of these offices. The testimony of the witnesses we will hear from over the next week will indicate in some instances this independence has been infringed upon and may need to be shored up.

This hearing will permit us to reexamine the authority of IGs and the degree to which their mandate has been carried out.

Thank you again, Mr. Chairman, and I am looking forward to the testimony of our witnesses.

Chairman GLENN. The first witness this morning is June Gibbs Brown, Inspector General, Department of Defense, and Derek Vander Schaaf, Deputy Inspector General, Department of Defense.

Will you come to the table, please?

Ms. Brown, we look forward to your testimony this morning. You may proceed.

TESTIMONY OF JUNE GIBBS BROWN, INSPECTOR GENERAL, DEPARTMENT OF DEFENSE,¹ ACCOMPANIED BY DEREK J. VANDER SCHAAF, DEPUTY INSPECTOR GENERAL

Ms. BROWN. Thank you, Mr. Chairman.

I am pleased to be able to testify before you this morning. I have been the statutory Inspector General under the IG Act at three Federal agencies, including NASA, Interior, and the Department of Defense. I have had the opportunity to see the wisdom of the IG Act borne out many times over. I think the Act was greatly enhanced in 1982, when the Department of Defense was added and

¹ See p. 153 for Ms. Brown's prepared statement.

received a statutory Inspector General. The amendments to the IG Act in 1988 were also very helpful.

I have several suggestions for refining the authorities of the statutory Inspectors General and for improving the conditions under which they operate. I do not want to imply in any way that I think the IG Act has not been successful. The Act certainly has been successful, but I do think there could be a couple of additional improvements that would be very helpful.

I would first like to mention a few of the accomplishments realized in DOD because of the Inspector General Act. We have created what is, in my opinion, the finest procurement fraud investigative organization in the world, the Defense Criminal Investigative Service. The work of our investigators has led to nearly 1,500 indictments, over 1,100 convictions, and monetary recoveries of \$685.5 million.

My office has issued very hard-hitting audit, inspection and other types of oversight reports that have led to potential savings and cost avoidances of \$9.5 billion.

The IG Act has also improved the coordination and cooperation between the DOD-level and military department audit, inspection and investigative organizations. I think that promoting better coordination is one of the greatest accomplishments made under the IG Act within the Department.

The Act has allowed the Inspector General to provide leadership within DOD in other vital areas, such as audit follow-up, hotline operations, ethics training, fraud awareness, and improving communication with contractors in such areas as internal controls.

Even more could be achieved, however, in the future with certain additional tools. They include testimonial subpoena authority for statutory IG's. The subpoena authority that we presently have under section 6(a)(4) of the Inspector General Act, is an essential, effective investigative tool, but it pertains only to records, papers and other documentary evidence.

If a witness or a person having relevant knowledge declines to be interviewed, the only way we have of demanding that interview is through grand jury subpoenas. Under the 6(e) rules of criminal procedure, that method can prove untimely because the information can only be used for criminal purposes. It cannot be used for administrative purposes unless it is court-approved, which is only in very rare instances. When we need more information about documentary evidence, companies can deny their employees the opportunity to speak to us. As a result, we cannot get the information needed to proceed in a timely manner.

Another tool that I feel would be very helpful is arrest authority. My criminal investigators are repeatedly called upon to work in perilous situations. We have many undercover operations going on where suspects are armed, yet we lack the fundamental law enforcement tool of arrest authority.

The third tool that I would endorse is policy and oversight authority for the Inspector General, DOD, over certain inspection functions of the military Inspectors General. This authority something should be parallel to the authority given under the IG Act for DOD audit and investigative organizations.

I respect the need for DOD component heads and commanders to have control over those inspection functions that are directly related to military readiness and operational matters, but I believe my office should have a better means to coordinate inspection activities which involve program efficiency and which can overlap with the DOD audit efforts.

I also would like to mention that Deputy Secretary Atwood has taken a personal interest in ensuring continued DOD emphasis on audit follow-up. He has sent all the DOD component heads a memorandum that clearly expresses his strong support for the program. In September he signed a revision to the basic DOD regulation that govern the internal audit follow-up program. In September he signed a revision to the basic DOD regulation that governs the internal audit follow-up program. He has very strongly supported these efforts and, without the appropriate audit follow-up in the department, our work would be very much less effective.

Finally, Mr. Chairman, you asked that I discuss the process for staffing the statutory Inspector General positions. Having served as IG for three agencies, under three Presidents, I do have some very strong personal opinions on the need to reinforce the non-political nature of the statutory IG's.

Certainly, all major political parties and responsible public interest groups agree that this is necessary. A statutory IG is simply not a partisan matter. The basic IG goals and objectives are not affected by political agendas, the rise and fall of budgets, or the relative popularity and visibility of individual Federal programs.

In July, I testified before the Investigations Subcommittee of the House Armed Services Committee on H.R. 2361, which provides a set term for statutory IG's, and I endorsed that concept.

I feel it is a credit to the professionalism and dedication of my past and present colleagues in the IG ranks, that the objectivity of their reports and activities has not been impaired by questions about their retention that arise before each presidential election and then grow to a crescendo afterwards. I think it would be wise to emulate the example of the fixed term of the Comptroller General of the United States. Such an action would remove perceptions that the activities of the statutory IG's may be either curtailed, slanted or even misused due to political considerations.

I would like to make it clear that I have never been told to alter a report or do anything else that would compromise my professional principles or ethics. The President went out of his way to meet with the IG's immediately after he took office. I feel that was a very meaningful gesture. The meeting occurred during the first week he was in office. Unfortunately, the signals from others during the transition were quite mixed.

At first, there was not much discussion, and I think all of the IG's went on with business as usual. Then in March we were advised that our status was being reviewed. I think that is always appropriate, and that IG's need to be reviewed on a regular basis. However, every month this was reiterated at meetings of the President's Council on Integrity and Efficiency, and the IG's began to operate under a greater cloud of uncertainty.

The first announcements are just starting to be made in September, regarding retention. The question is moot for me personally,

because in August I decided to pursue other career opportunities. I am leaving my position in DOD next month. I can assure you that no one in DOD has ever given me anything but positive feedback. The Secretary has given me an outstanding rating on my performance and he has neither stated nor implied that I might not be retained.

However, for the sake of the maximum effectiveness of the IG community, I will continue to urge that the unique nature of the IG function be protected. The need to avoid perceived impairments to that function should be recognized.

If Federal managers want to attract and retain the best candidates, the appointments must be as required under the IG Act, without regard to political affiliation and solely on the basis of integrity and demonstrated ability in accounting, auditing, financial analysis, law, management analysis, public administration or investigation. Retention should not be based on the transition of administrations or on the IG's position on a particular matter. Instead, the entire body of work produced by an IG must be reviewed over a reasonable interval of time.

The concept of the IG is still relatively new, and perhaps it is not surprising that issues such as this arise. In 1981, President Reagan fired me, along with all other statutory IG's. I was one of those who came in originally under the 1978 IG Act. President Reagan then reappointed six of us several months later. That experience, plus the protracted period of uncertainty that has taken place during this change of administration leads me to very strongly endorse the concept of a fixed-term.

We have many DOD management challenges and I have discussed these in my written statement. There is a whole list of them, which I will not go over now. I also have a list of some of the ongoing criminal activity that is being investigated by my office. The list includes product substitution, bid rigging, theft of military equipment, bribery, cost mischarging, intentional defective pricing, and medical fraud.

I will leave the reading of that to those who are interested and I will certainly be available for any questions you or the Committee may have.

Chairman GLENN. Thank you very much, and I do recommend that reading to people who can report on this and keep some attention focused on this. Those are all areas that we wish to followup with your successor over there.

Mr. Vander Schaaf, do you have a statement for us this morning?

Mr. VANDER SCHAAF. No, I do not, Mr. Chairman.

Chairman GLENN. All right.

Ms. Brown, you refer in your testimony to an ongoing investigation with regard to agencies or parts of the Department of Defense having funds diverted to other agencies, such as the FedLink program with the Library of Congress. What other agencies are getting this money and how does that work and why is it being used?

As I have seen it now—it could be almost termed a laundering operation operating within government to avoid end-of-the-year fiscal constraints or budgeting problems that we have. Would you

refer to it as that, or does that overstate the problem? Could you explain it to us first and how it is working?

Ms. BROWN. Well, this is a legal capability, it is not outside of the law. However, it is a procedure that has been undertaken in order to avoid some of the constraints and the regulations that surround the contracting process. Therefore, it avoids many of the controls that have been put in place as well.

It has escalated astronomically since it started. Mr. Vander Schaaf has been working on that and perhaps he has some other comments.

Mr. VANDER SCHAAF. Well, with respect to the one case we mentioned to the staff, and we have obviously informed people in the Defense Department as well, it involves the Library of Congress. We in the Department of Defense ended up doing some \$83.4 million worth of business with the Library of Congress in FY 1988. This represents an increase from \$35.6 million in FY 1987. The Library reports that overall acquisitions for DOD and other agencies through FedLink amounted to only \$7 million in FY 1981 and \$22 million in FY 1985. It has been used as a way of obtaining contracts for consulting and advisory-type services, without going through the procurement regulations. It allowed the granting of contracts without getting cost or pricing data, without making cost reasonableness determinations, without doing any of the contract management functions that are so essential to insuring that funds are well spent. It, of course, also gives some individuals in government an opportunity to direct a contract to a particular individual or firm.

The way the process works is to place an Economy Act order with another government agency, which in turn has a long-term contractual arrangement with an organization which subcontracts as they see fit. One example at the Library of a directed contract is the Army's Health Care Systems Support Activity, which decided it needed some work and went to the FedLink program. FedLink is a program that the Library of Congress managed. The Library had a contractor called Innovative Technology that provided library-type services and that was willing to subcontract on the Army's behalf with a preselected contractor. Part of the agreement required the Army Health Care System Support Activity at San Antonio, Texas, to purchase a \$4,190 subscription for the standard library service that Innovative Technology offered through FedLink. In return, Innovative Technology subcontracted all the work to the Army's preselected contractor. The value of the arrangement was \$4,300,000.

I just use that as one example. We are doing a lot of work in this area right now. We have also looked at these Economy Act orders with the Department of Energy, and their use through the Oak Ridge Laboratories. We have been looking at this process at other Federal research centers as well. The whole idea behind the Federal research centers was to establish expertise in-house, and to avoid various contractual problems, delays, et cetera. We would have an in-house resource that we could depend upon. The research centers were not limited in the people that could be hired, because they could pay wages above government salaries, et cetera.

But if these Federal research centers are going to subcontract the work, without competition and without controls, then I think

we have voided their very purpose and have just messed up the system. We are looking into that problem right now and we have reported it to management in the Department of Defense and in the Office of Management and Budget. We consider it to be an internal control weakness.

Chairman GLENN. Have you had any indication of particular individuals benefiting from this on subcontracting and any payoff or anything like that?

Mr. VANDER SCHAAF. Not yet. There are probably some which will be looked at. But at this point—I am not prepared to talk to any specific one—

Chairman GLENN. Does this type of procurement go up toward the end of the fiscal year, as a way of avoiding a lapse of funds in a particular year?

Ms. BROWN. I have not seen the trend according to the season, but it certainly is a way of expediting the contracting process and allows one to have more control over the selection of the entity with which you want to contract.

Mr. VANDER SCHAAF. At two of the activities, where we are the farthest along with our audit work, it is clearly so. For those orders placed with DOE, 25 percent was obligated during the last month of the year and about 40 percent of obligations occurred during the last quarter of the year.

Chairman GLENN. So that would be \$800 million, then, contracting for—

Mr. VANDER SCHAAF. Something like that. I want to check those figures for the record, but it was about 40 percent of the dollars came in the last quarter of the fiscal year.

Chairman GLENN. Did that just happen, or was this something that was done deliberately to avoid a lapse of \$800 million worth of authority?

Mr. VANDER SCHAAF. Obviously, some of it was done to avoid funding lapses. In fact, there are examples with the Library of Congress, where money is in fact put on order using these procedures and then it is de-obligated later on. The Library, of course, kept its 5 percent management fee and then passed the money back to the users who could then reuse this money and extended the life of those funds.

Chairman GLENN. Does any of this money come back after the end of the fiscal year? Are there any ways that have been devised to obligate it some way and then have that money transferred back in after the end of the fiscal year?

Mr. VANDER SCHAAF. Yes, that is one of the objectives that can happen.

Chairman GLENN. How can they do that?

Mr. VANDER SCHAAF. The money is de-obligated. The contract is not put through and the money goes back to be used for something else.

Chairman GLENN. But it would not, in effect, be out of date, then, as previous year money?

Mr. VANDER SCHAAF. It would depend. It could be out of date in some cases. We are looking at some of that now, to try to sort that out.

Chairman GLENN. How far into this have you gotten? When can we expect a report on this?

Mr. VANDER SCHAAF. I would say by the end of the year we will have this finalized, certainly the Library of Congress report. The DOE report will be a bit later.

Chairman GLENN. Maybe this is a coincidence, but one of the people that was in charge of this over at the Library of Congress resigned when Library of Congress IG personnel sought to interview him. Is that your understanding, or was he going to retire anyway? Do you know?

Mr. VANDER SCHAAF. I believe you are correct, Senator. I do not know the exact circumstances. The Inspector General at the Library has, in fact, looked into the matter from their end and has issued a report on it.

Chairman GLENN. All right.

Ms. Brown, the defense industry often complains about the burdensome document requests and subpoenas your office issues and claim that all or most of DCA auditors are being utilized as criminal investigators. They claim there is inadequate coordination of government auditors in oversight. What do you say to those criticisms?

Ms. BROWN. Well, if I could take each part of your question individually. Last year, Mr. Vander Schaaf and I, signed approximately 670 subpoenas. These are very carefully screened. We are signing them for the entire Department of Defense, for each of the military criminal investigative organizations, as well as the Defense Criminal Investigative Service, which is part of my office. So, we have four separate organizations. They are used almost entirely for criminal investigations. It is very rare that we use them for some type of administrative matter, although that does happen on occasion.

I think that careful research would reveal that these are necessary tools. We are ensuring that we get the documents that are necessary to do an in-depth investigation. A company cannot come back later and claim that they did not understand what was being requested and therefore did not supply the full information. It really creates clarification in the process.

I certainly do not think this is an unreasonable burden, but it is a tool that has been used very aggressively in order to get the information that is necessary, particularly in criminal matters.

Now, as far as the coordination within the Department of all audit and investigative activity, I think that has improved substantially since the statutory IG was created in the Department of Defense. I meet regularly with the head of each of the audit services and the head of each of the investigative services and also the main military IG for each of the services, the Joint Chiefs of Staff, and so on. We coordinate our work. That is being done to a degree that has never been accomplished in the past and we can eliminate a lot of duplication and overlap.

The new report of the President on defense management will cause the acquisition functions to be further coordinated and combined within the Department. I think that will greatly enhance the procurement process by avoiding duplication. We now have several organizations that have oversight responsibility.

Chairman GLENN. You also mentioned also actual bogus health care providers, false requests or false submissions for payment. What types of schemes are being used to defraud DOD, and do these efforts represent failures to have proper controls in those programs? That was just out and out fraud, as I understood your statement.

Ms. BROWN. Yes, sir, this was old-fashioned fraud. There is nothing subtle or gray about this.

Chairman GLENN. How major is it?

Ms. BROWN. We have a very major undertaking right now which will involve literally hundreds of providers. We have had our first few indictments, but there is a great deal going on that I cannot discuss at this point, because it is still an active case.

Chairman GLENN. How much money would be involved, as you see it right now?

Ms. BROWN. Hundreds of millions of dollars, certainly.

Chairman GLENN. Hundreds of millions.

Ms. BROWN. We do not have a final figure, but it is very substantial. The type of scheme varies, but generally people would be asked to come in for free physicals and in the process of receiving a free physical, they are asked to fill out a questionnaire about their medical condition and their past history. The providers then take that historical information on the individual and put in bogus claims for various tests that would be appropriate, based on their medical history. In most cases, these tests are not given at all. In some cases there is not even a legitimate lab that is supposed to be providing these tests. They are putting in massive numbers of claims and getting reimbursement for them.

Chairman GLENN. You feel that there may be hundreds—my time is up—you feel there may be hundreds of millions of dollars—

Mr. VANDER SCHAAF. No. There may be that much money flowing through this the particular area of the country where we have been auditing and investigating, but I would say that the amount of fraud is considerably less than that.

Chairman GLENN. But do you have any figure you could attach to it, off the top of your head?

Mr. VANDER SCHAAF. I do not have it, Mr. Chairman.

Chairman GLENN. It would not be in the hundreds of millions, but it is more than \$1 million, certainly?

Mr. VANDER SCHAAF. Oh, yes, it is certainly in the \$10 million category or \$20 million category. I do not think it will reach \$100 million.

Ms. BROWN. The fraudulent aspect of it would be less than that. There are hundreds of millions going through this system, of which a very substantial portion is being lost through fraudulent claims.

Chairman GLENN. I ran a little over on my time there, Bill.

Senator ROTH. Thank you, Mr. Chairman.

Let me ask a couple of questions on matters raised by the Chairman. Now, the Library of Congress is responsible to Congress, is it not?

Mr. VANDER SCHAFF. Yes, sir.

Senator ROTH. Are they under different rules in letting contracts than the Executive Branch?

Mr. VANDER SCHAAF. Yes, my understanding is they are. The Federal Acquisition Regulations are not applicable to the Congress. Therefore, contract administration and those kinds of functions can be conducted without the rules we in the Executive Branch operate under.

Senator ROTH. Mr. Chairman, I would suggest that we have the staff look at that. Maybe there is good reason for that exemption, but it may just be a wide loophole. And, secondly, it seems to me that we ought to make it clear to the Librarian that it is not intended, whatever authority may have been given them for special reason, to be utilized to avoid the procedures.

Mr. VANDER SCHAAF. The program that started is very reasonable. It was to help the libraries of the Nation gain access to information sources and to acquire new software. Then somebody got the bright idea to help finance the operations of the library simply by passing this money through the process, taking their 5 percent plus fees piece of it, and then, using that to operate and otherwise buy labor for the library. It is not the way to do business. We who work in the government should ensure that all contractors and all individuals have a fair and reasonable opportunity to bid on these contracts, but when you do it this way, the system just does not work.

Chairman GLENN. Well, I think we have to look at that, obviously. I think you indicated, too, I believe, it is not just the Library, you have seen this in TVA and some other places, too, is that correct?

Mr. VANDER SCHAAF. Yes. As a matter of fact, we have been auditing for close to 6 months a number of projects accomplished through Oak Ridge Laboratories, which are under contract with the Martin Marietta Corporation. The orders go into the Department of Energy, into Oak Ridge, and then Martin Marietta subcontracts that work. We have numerous examples of what we think are contracts that were poorly managed in costs that were incurred, and we will be continuing to work on that as we go. As I said, we have alerted the Department of Defense to this matter.

Senator ROTH. Well, not to belabor that point, let me ask one question with respect to the fraudulent claims under the medical programs. Are the doctors that are involved in these false claims being barred? The reason I raise that is because I held hearings, Mr. Chairman, way back when I was Chairman of this Committee, on this very problem, where false claims are being made. I am not sure it was Defense at that stage, I think it was partly HHS, but we could not witness any action being taken against the doctors. They were able to continue to provide these services under the various health programs. Has anything been looked to see what actions are being taken against them?

Ms. BROWN. In the particular case that I was describing, we have only had our first few indictments, so we have not gone that far with it. We have made extensive progress in the Department of Defense, though, in seeing to it that information is provided to the State authorities so that debarment can occur. We have cases of people who have left the service, or at least stopped working for the military, because of malpractice of some kind, including sexual abuse. At one time that information was not provided to the State

licensing authorities so they could take appropriate action to keep these people from continuing their practice on the outside. We have made considerable progress and that information is now provided, and follow-up action is taken.

Mr. VANDER SCHAAF. And, Senator, these doctors have been debarred from doing work with the Department of Defense. It does not necessarily mean the State licensing boards have, in fact, removed their licenses. But they will no longer be able to bill the CHAMPUS program for services, because they have been suspended or debarred.

I should also add that this particular investigation that Mr. Brown mentioned is being joined by HHS investigators from the Office of Inspector General there and other agencies. It is the same scam as used with other Federal health care programs.

Senator ROTH. Well, I would urge that you investigate whether these doctors go from one program to another, because that was another part of the problem. They would be picked up for improper claims under one of our medical programs of one of the agencies, and they might be barred under that, but they still continued to provide services. So, I would be interested in having that followed through.

Chairman GLENN. We are on a vote and I am going to run and vote and you continue as long as you can and I will come back as soon as I can.

Senator ROTH [presiding]. Thank you, Mr. Chairman.

One of my keen interests is whether the system is really working. I mean, we can zero in, Congress loves to zero in on something that makes headlines, but that really is not protecting the taxpayer's dollar. The real question is whether there is a system in effect that is helping insure that the dollar is being well-spent.

Now, I take great pride, to be candid, that we have an independent Inspector General at the Department of Defense, because it was during my chairmanship we got that through, despite the opposition of that agency for many years. And one of my concerns at that time was that the internal audit—I cannot remember what they call that group—I thought was totally inadequate, ineffective, played too close a game with the contractors.

My question is, would you testify here that the financial records are adequate, good, superior, inadequate, and how do you see the audit of those records internally being maintained?

Ms. BROWN. Sir, that is not an easy question to answer. I might say that there are many different financial systems within the Department.

Senator ROTH. So, not only do we not have one system between agencies, we do not even have one consistent one within the Department of Defense?

Ms. BROWN. Well, certainly within each military department, there are various systems for logistics, pay, and so on. However, having worked with all the IG's, and having been an IG, as I say, in three agencies, I would like to go on record to make the statement that the Department of Defense is the best run agency that I have ever seen, in spite of all these problems. We are overworked, I feel, but we help recover or save billions of dollars and see that money is put to better uses. We have followup systems in place,

and the fact that we are detecting the problems and doing something about them is to the Department's great credit. We have a very good follow-up system.

Senator ROTH. Like you say, that is going to come as a shock to many, but go ahead.

Ms. BROWN. We have an excellent follow-up system in the Department of Defense. I do not think any of the other Departments have one that compares with it. We track all outstanding recommendations, including all the GAO recommendations, and see to it that the appropriate actions take place. The recommendations are followed up for the whole time until we get implementation of the corrective actions.

Where we do not have agreement on a particular recommendation or finding, we elevate it within the system, and we can continue that elevation until it reaches the Deputy Secretary's level. Then, some other representative from my office, together with perhaps a Secretary from one of the military departments, bring the issue to the attention of the Deputy Secretary of Defense for a final decision. Elevating recommendations gets tremendous visibility when we cannot get resolution within the staff.

The very fact that IG issues can be elevated to the Deputy Secretary level creates an environment where you do get resolution on most matters. At one time I think audit findings and recommendations were often lost in the process or not acted upon. In contrast we are now getting improvements and corrective actions.

Senator ROTH. Well, I am going to have to run. I guess that is one reason we have inadequate oversight. I do want to mention, because I am not sure of the Chairman's intent, that I know that Senator Cohen, who was unable to attend today, does plan to introduce a bill to give testimony subpoena power to the DOD IG. Would you care to quickly comment on that?

Ms. BROWN. That would be of tremendous help. I think we could get far more efficient use of our resources if we were given that additional tool, and I am very pleased to hear that.

Senator ROTH. The Committee will be in recess now temporarily. [Short recess.]

Senator LEVIN [presiding]. The Committee will come to order.

Ms. Brown and Mr. Vander Schaaf, let me just ask you a few questions. We might as well use this time while the Senate is voting.

Ms. Brown, when you are asked by the Congress to investigate a problem or when you receive a hot line call, do you refer the matter typically to the service IG, who in turn refers it to a command IG, who may in turn refer it to a subordinate command IG?

Ms. BROWN. Well, it varies, Senator. Certainly, some of them are referred through the chain that way. We look at the individual Hotline complaint, and we get approximately 1,000 calls or communications per months through the Hotline. We have a network of I.G.'s throughout the world and there are people on-site who can do investigations. If it involves a senior official, for instance, that would be handled differently. We see to it that that kind of case gets a great deal of visibility. In fact, we have had extensive meetings and worked out procedures on this, so that there would not be

any withholding of information by an organization. Such issues do get visibility and top level attention.

Senator LEVIN. When the matter is referred to a service IG, the actual investigative work would not be done by your personnel with their statutory guarantee of independence, but would be done by personnel inside the service who do not have that statutory guarantee, is that correct?

Ms. BROWN. That is correct, yes. However, we follow up, and if we do not feel that an adequate job has been done, we can either ask for continued work or take over an investigation.

Senator LEVIN. About how many of the thousand calls per month coming into the hot line would be referred to the service IG's, and how many would be retained at the beginning by your office?

Ms. BROWN. Well, there are approximately a third that we feel require some kind of follow-up activity, that is, there is enough substance after an initial look to warrant some kind of work. Of those, I do not have the statistics, but I am sure at least half are referred through that chain.

Senator LEVIN. Is it possible that it could be as much as 90 percent of those that have some substance could be referred to the chain?

Ms. BROWN. I would have to get an accurate figure for you, sir.

Senator LEVIN. If you could just give us an estimate.

Ms. BROWN. All right.

Senator LEVIN. It does not have to be precise, just give us an estimate for the record, that would be fine.

Ms. BROWN. All right.

[The information referred to follows:]

In 1987, 1988, and 1989 (through November 9, 1989), the DoD Hotline referred to the military services 2,405 (89.21%) of the 2,696 Hotline cases concerning the services which were opened. The percentage of military service cases referred to the services has steadily decreased—from 93.28% in 1987, to 90.63% in 1988, to 83.15% thus far in 1989. The percentage of military service cases retained by the Office of the Inspector General, DoD, has increased correspondingly.

It is noted that these figures include that category of cases ("information referred") on which the Hotlines does not task the services to act, but which it nonetheless refers to the services for information and whatever action the services consider appropriate. When "information referred" cases are subtracted, the figures are somewhat different. Of the 1,987 Hotline cases concerning the services which were referred for action in 1987, 1988, and thus far in 1989, 1,700 (85.56%) were tasked to the services. In 1987, 90.85% were tasked to the services, in 1988, 87.57%, and thru far in 1989, 77.27%.

It should be noted that the Department of Defense components are required to report the results of their audits, inquiries, and investigations to the DoD Hotline. Hotline closing reports are individually reviewed by professional investigators on the Hotline staff for independence, objectivity, adequacy, and timeliness. Deficiency reports, describing shortcomings of components' Hotline completion reports and the corrective actions necessary to eliminate those shortcomings, are used to return to components those completion reports which do not meet the Hotline's criteria. Additionally, the DoD Hotline conducts periodic, on-site reviews of the DoD component offices to which it refers cases for action. In these quality assurance reviews, professional Hotline investigators examine the field investigative files to ensure those files contain recommendations presented in Hotline completion reports. These findings, together with assessment of components' records of independence, objectivity, adequacy, and timeliness in acting on DoD Hotline cases, are reported to top-level component managers who are in a position to correct any deficiencies found.

Senator LEVIN. Now, what about the problems that are referred to you by Congress or by a Member of Congress, are they handled the same way, or are many of those referred to that chain, too?

Ms. BROWN. It depends on what the problem is, not the source of the problem.

Senator LEVIN. So that the percentage of matters which are investigated by the IG's office, your office, compared to how many are referred to the chain IG would be the same percentage, probably, for problems referred to you by Members of Congress as it is for problems coming over the telephone or the hot line?

Ms. BROWN. No, because those coming from Congress usually are more substantive. As a result a greater percentage would be kept within our office.

Senator LEVIN. But the test would be the same, as to what was kept and what was referred, the standard would be the same?

Mr. VANDER SCHAAF. If I could add something here, the standard also involves the degree to which someone in the Department may have looked at the problem before. If it comes from Congress and no one has looked at it before, if it looks like it will be significant, we obviously retain it, Senator Levin. On the other hand, if it comes from Congress, and it is significant but we know it has been addressed elsewhere before, but the letter says it has not been properly addressed, we would retain it again. However, if the letter says would you look into this matter and we know someone else is looking into it already, we would then send it down the chain of command.

Senator LEVIN. In your prepared testimony, you indicated that the DOD IG needs additional policy direction and oversight authority over the service IG's. What specific additional authority do you believe is needed over the service IG's?

Ms. BROWN. Well, a great many of the inspections are very closely related to audits, so both might be looking at major weapons systems or something of that nature. I think the coordination that needs to take place should be similar to the procedures followed by the audit or investigative organizations. We should have that oversight responsibility under the law.

Right now, I am working closely with each of the Service IG's and we are sharing information. We meet on a regular basis, but there is not any statutory authority for this coordination as there is in the audit or investigative areas.

Senator LEVIN. Should some of the functions of the local IG's be consolidated at a higher level, either with the service IG's or with the DOD IG?

Ms. BROWN. I believe so, but the inspections function operates differently in each of the Services. For instance, in the Navy, it is very decentralized and the IG's at the local level do not work for the Navy IG. In Air Force, there is a full chain feeding into the service IG. Even the Office of Special Investigations works for the Air Force IG. So it varies substantially between the Services and we do not get the kind of network that I think the Department needs.

Senator LEVIN. If others do not pursue this area with you, it would be helpful if you would expand on that answer for the record, if you have any additional thoughts as to what functions of

local IG's should be consolidated at a higher level, and also any other changes in the structure of the service and command IG's you might recommend, where there might be a problem.

Ms. BROWN. I will do so, Senator.

[The information referred to follows:]

The oversight structure of the Department of Defense needs to be viewed in its entirety when discussing the roles and structure of audit, inspection, internal review and investigative organizations. The exact functions of a unit, installation, or command level IG should be determined primarily by what the local commander's needs are and to what extent those needs can be most effectively met by an onsite IG, as opposed to audit, internal review, criminal investigative, and other resources that may be available to the commander at the local level. Secondly, the needs of higher level headquarters with oversight responsibilities and interests must be considered. Greater consolidation or centralization of IG operations yields benefits in terms of increased ability to look at system-wide and cross organizational issues. There is also an enhanced perception of objectivity and freedom from undue command influence. Greater decentralization, on the other hand, yields benefits in terms of greater responsiveness to the local commander's requirements, including the quicker reaction enabled by permanent, onsite presence.

Each Military Department is organized quite differently and has a wide range, even internally, of individualized missions, functions and management challenges. Both the needs of individual commanders and the kinds of oversight resources available to them differ considerably. Therefore the Services have chosen to manage their IG organizations in ways that are felt to meet their particular needs best at all management and command levels. The concept of DoD-wide uniformity in determining the functions and structure of military IG organizations is probably impractical.

The Inspector General, DoD, does believe that coordination between the DoD audit, inspection, internal review and investigative communities could be improved. Some inspection standards and procedures could also be made more uniform. Although much has been accomplished along those lines since the creation of the Office of Inspector General in 1982, we have supported legislation introduced in the House (HR 2361) to extend the statutory authority for policy direction and oversight by the Inspector General DoD, to most Military Department inspection operations. Likewise, we favor greater budget visibility for the Military Department audit, inspection and investigative organizations. With those tools, we would be in a better position to ensure that the inspection portion of the DoD oversight effort was effective, efficient, and well integrated into other, similar oversight programs.

Senator LEVIN. Finally, do you believe that a GAO study of the structure and its impact on the independence and objectivity of the service and command I.G.'s might be helpful, a GAO review of that?

Ms. BROWN. I think we have a great deal of study that has been done in this area. Certainly, additional information always adds another dimension, but I do not think we have not made decisions for lack of information.

Senator LEVIN. Would you let us know what studies already exist in this area addressing that question?

Ms. BROWN. Yes.

[The information referred to follows:]

Reports on the Military Department Inspectors General include the following:
General Accounting Office (GAO) Report FGMSD-78-42, "Is the Air Force Inspection System Effective," June 29, 1978

GAO Report FGMSD-79-61, "A look at the Air Force Inspector General's Inspection System," August 28, 1979

GAO Report FGMSD-80-1, "The Army Inspector General's Inspections—Changing from a Compliance to a Systems Emphasis," October 30, 1979

GAO Report FGMSD-80-20, "The Marine Corps Inspection System Should Use Resources More Efficiently," December 20, 1979

GAO Report FGMSD-80-23, "The Navy's Inspection System Could Be Improved," December 26, 1979

Task force on Evaluation of Audit, Inspection and Investigative Components of the Department of Defense, "A Report to the Congress and the Secretary of Defense: The Department of Defense and the Inspector General Act of 1978," May 1, 1980

Senator LEVIN. Thank you, Mr. Chairman.

Chairman GLENN [presiding]. Thank you, Senator Levin.

Just a couple of questions, to wind up on some of our previous questioning before I went over to vote, because we do have to move along even though I would like to continue with you all morning here. We have enough to get into.

On the Fed Link example you used, the numbers of dollars involved there, compared with other agencies or other groups that are being used in the same way, could you compare that? For instance, I understand that DOE Laboratories are involved with this, and TVA.

Mr. VANDER SCHAAF. I want to clear one thing up for you. The total going from DOD to DOE under these Economy Act orders last year based on a GAO report was about \$2 billion. A good portion, I would say in the neighborhood of \$270 million during FY 1987 went into the DOE Laboratories at Oak Ridge, and some went to other places. But it is all money that is not related to DOE's defense mission. That is directly appropriated to DOE. I am talking about work that DOE does for the Department on a reimbursable order basis, and that is about \$2 billion a year.

Chairman GLENN. Okay. Is this—

Mr. VANDER SCHAAF. That is much bigger, of course, than the Library of Congress example I used.

Chairman GLENN. It is indeed. It makes it look small, by comparison. The Library is just one little—

Mr. VANDER SCHAAF. But doesn't the fact that we do \$83 million worth of business with the Library of Congress a year, surprise you, Mr. Chairman?

Chairman GLENN. It surprises me.

Mr. VANDER SCHAAF. It surprised me.

Chairman GLENN. Yes, but you are talking billions now, when you get off into the other agencies. In your opinion, is this being done—

Mr. VANDER SCHAAF. I would say probably DOE is our biggest reimbursable, where we place the most reimbursable orders.

Chairman GLENN. This would be on items that are not normally funded out of DOD-DOE companion projects?

Mr. VANDER SCHAAF. Yes. In other words, a significant portion is not nuclear weapons development or the production end of the business. That is all appropriated directly to them.

Chairman GLENN. Is this mainly a way of avoiding normal procurement procedures, or is it mainly to get rid of end-of-year funds so we then still have them available, or both?

Mr. VANDER SCHAAF. Much of this work is essential. If we have an expertise in government, the whole idea of the Economy Act is to use that expertise that one agency has developed or, has under contract, or it could be in the form of a Federal research center and have another agency take advantage of this situation as an effective means of getting the job done.

All I am trying to say to you is that we have indications, and we have been looking into situations where the system is being abused.

It is being abused to avoid the Competition in Contracting Act, and that is wrong.

Chairman GLENN. Okay. Are any of these classified contracts?

Mr. VANDER SCHAAF. I am not sure. I would expect some might be, although for the most part I do not know. I would guess some are.

Ms. BROWN. I do not know.

Chairman GLENN. Would the Library of Congress have the appropriate personnel cleared to work on classified contracts? I would presume that some—

Mr. VANDER SCHAAF. Oh, with the Library of Congress. I thought you were talking about—

Chairman GLENN. No, I was talking about our—

Mr. VANDER SCHAAF. I think none of these are classified contracts with the Library of Congress, but with DOE some of these would be classified.

Chairman GLENN. All right.

Mr. VANDER SCHAAF. Some of these may be classified, in terms of Soviet studies and that kind of thing, which may be legitimate, but that is different—that is not the FedLink program that I am talking about. Through FedLink, we also bought services like ADP hardware, software from various firms, studies, but which were not done internally within by the Library.

Chairman GLENN. Have you found cases, though, where it was transferred out of one year and then came back into DOD the following year, just to avoid the end-of-year restrictions?

Mr. VANDER SCHAAF. I believe there are such cases, sir, and I will explain this further in the record.

[Information referred to follows:]

FEDLINK TRANSFER OF DOD FUNDS BETWEEN FISCAL YEARS

The amount of DoD funds being carried over from one fiscal year to the next under the Library of Congress's FEDLINK procurement program has grown substantially in recent years. The Library reports that \$6.3 million of DoD funds were carried forward from Fiscal Year 1987 to Fiscal Year 1988 and that the amount of DoD funds available for carryover at the end of Fiscal Year 1988 had grown to \$37.9 million. The Library reports that the original intention of permitting these fund carryovers was to provide for the payment of vendor invoices that were in transit at year end. There are now indications that in many instances these DoD funds are being "parked" with FEDLINK until the DoD activity can determine how they want to use the funds. For instance the Library reports that the Army Directorate of Combat Development transferred \$474,000 late in Fiscal Year 1988 to the Library to provide for services with an estimated value of only \$78,000. This technique enabled this Army activity to "park" approximately \$396,000 of Fiscal Year 1988 funds with the Library of Congress to be used for projects to be determined in Fiscal Year 1989.

Chairman GLENN. That is an area I certainly want to follow up on, and I would appreciate any additional information you can give us on that.

There is one other area I wanted to get into, too. This Committee, about, 1½ or 2 years ago now, got into this area of long supply in DOD, and you are familiar with that. Long supply, for those who are not aware, is basically a euphemism. Long supply means basically we contracted for something that we either now do not need or we cancelled the project, we have equipment that is no longer needed for that project or something, we do not want to throw it

away, but we have no known use for that particular item. That is a very basic fundamental description of it.

In the military buildup that went on during the early part of the last administration, we had had in long supply somewhere about \$11 billion, as I recall, and in 6 years, from 1981 up through 1986, I think, if I recall correctly, long supply had gone to over \$30 billion. Now, that is a \$20 billion flat-out waste, and you are looking into that. Have you completed your audits on that? When can we expect a report that defines that for us?

Mr. VANDER SCHAAF. There are so many audits in this area between our office, Senator, and the General Accounting Office. I have a list in front of me. I guess it must have 20 or so in 1986, 1987 and 1988, those three years, and it is a whole series of problems. It is not one single problem.

We are prepared, to talk about that. In fact, this Committee, I have been here and addressed these issues with this Committee before. However, I have to take some exception when you say that \$30 billion was all wasted. I do not think that is a fair assessment. We buy weapons systems, they become old, and we have supply and support for those weapons systems that are no longer needed in the inventory and the support structure. The supply of repair parts, et cetera, that supports those obviously become long supply and excess. It does not mean it was a total mistake to do that.

Now, I am not saying we do not from time to time have items on order that are already in long supply. We should cancel those orders and we are not doing a very effective job of that.

Chairman GLENN. Well, long supply, the definition we used during the hearing was long supply, were things for which there is no known use—

Mr. VANDER SCHAAF. Oh, absolutely.

Chairman GLENN [continuing]. So that means that somebody fouled up on the procurement some way, did not make the right estimates or something.

Mr. VANDER SCHAAF. No, not necessarily so. That is one factor in it, but it could be that it was an appropriate level of reserve, if I can use those terms, at one point. For example, we had spare parts to support a particular vehicle. The vehicle is replaced by a new vehicle that accomplishes the same purpose in the Armed Forces. Then those items become long supply, because the demand for those items is no longer what it used to be. So you should not assume that is all waste, Senator.

Chairman GLENN. Okay. We wind up by taking all our time on long supply here, but when we looked into long supply, we found that the people doing the ordering of spare parts were completely—you know, they had ordered enough for like 75 years of replacement parts on a 104 or whatever, and that is not an actual example, but they had not tailored the buying of these things to the expected life of the airplane, what was tailored when we knew other programs were coming along to replace certain equipment and gotten completely out of hand, and so we had supplies for which there was no known perceivable use, and that is where it was all fouled up and we had added something like \$20 billion to our defense expenditures unnecessarily because of that improper planning and procurement.

Mr. VANDER SCHAAF. I will agree that there are a lot of examples of poor management in this area. We constantly uncover situations where we order an item that we already have in our stocks in a long supply status. DOD buying centers often go to a manufacturer to buy a new item that uses as a sub-system the items that are in long supply. We allow them to go out and buy more of this item even though we already have it in the warehouse in long supply.

Chairman GLENN. Because we did not know—

Mr. VANDER SCHAAF. Because we did not look.

Chairman GLENN [continuing]. What we had.

Mr. VANDER SCHAAF. There are problems like this, but I do not want to leave the impression that I agree with you that all \$30 billion is waste.

Chairman GLENN. Fine. Thank you. Well, we will continue on that one.

Senator ROTH, do you have any last burning questions? We are going to have to move on shortly.

Senator ROTH. Let me ask one or two questions.

Now, you issue a semi-annual report, and then is there not a 7-day letter? Have you issued any 7-day letters?

Ms. BROWN. No, sir, we have not. That is to be used when you cannot get resolution or when there is a particularly grievous situation and we need to get information to the Congress. We have not had those situations. We do get responses from the Department and there have been no instances where they are covering up or denying the existence of a problem.

Senator ROTH. Let me ask you, on what basis would you say yes?

Mr. VANDER SCHAAF. Well, we came very close to issuing one at one point. Senator Glenn will be familiar with the circumstances. We were trying to audit aircraft gun spare parts and the quality of those parts at the Warner Robins facility. The Air Force was giving us a terribly bad time with access. I went to Deputy Secretary Taft at the time and told him that we had to do something about this and he took appropriate action. We had been delayed for many months in this process. We would have issued—I was by myself at that point—it was between Mr. Sherick and Ms. Brown—I certainly was prepared to issue a 7-day letter if there had been no appropriate resolution of the problem. It turned out that Defense management supported us and we did not have to issue a 7-day letter.

Senator ROTH. Have there been any hearings based on your 6-month letter, has there been any oversight by the authorizing subcommittee on appropriations or anyone else in Congress on the—

Ms. BROWN. Based on our reports?

Senator ROTH. Yes.

Ms. BROWN. Yes, certainly things have come up in the report. We also provide copies to members of completed audits and, based on those, we have had many hearings, so I think Congress is keeping up to speed very well on the work that our office produces and holds hearings on a regular basis.

Senator ROTH. One final question. You stated that your office and the GAO have identified quality assurance problems that allow large quantities of inferior material to enter the DOD supply system, and that these are DOD-wide problems. You also stated that, in response, DOD has recently instituted an action plan to ad-

dress the problem, but that not enough is being done either in testing or in penalizing poor or non-performance by contractors. Is this a newly discovered problem, or is it one that has been known for a long time?

Mr. VANDER SCHAAF. It is certainly not newly discovered. I think this problem of quality in the manufacture of goods in the country is a national problem, Senator Roth. The Department is attempting to address it through a program called total quality management, using total quality management principles and techniques to fix it over the long run.

We are concerned that we have got to get in and take a look at what is actually on the shelves, on at least a random basis, and find out to what degree that material in our warehouse shelves complies with the specs that exist. The Chairman held hearings on this subject last April, with respect to some of the audit work we have done. It was surprising to see, the degree to which the percentage of the items on the shelves, based on statistical sampling that we checked, were non-conforming and, in many cases contained major non-conformances.

We have some audit work ongoing right now, and we use laboratories to check these things. This work is going on at the Industrial Supply Center in Philadelphia. A very large percentage of the items on the shelves do not comply with the specifications under which they were purchased.

Senator ROTH. What, if anything, is being done to penalize those who are supplying inferior material, whether willfully or by negligence?

Mr. VANDER SCHAAF. That is one of our gripes. We do not think there is enough action to suspend contractors or to bar contractors who have provided this kind of material in the past. They are allowed to re-bid again, even though their material has been proven to be faulty in the past. There is not enough discipline in the system. That is something I testified about in April when I was here talking about that problem.

Senator ROTH. It is October now.

Mr. VANDER SCHAAF. Well, there is a plan, as your question mentioned, a quality plan that is being worked on in the Department. To the best of my knowledge, the plan has not been signed and approved by the Deputy Secretary of Defense. As far as I know it is on its way to his desk or it is on his desk at the present time.

Senator ROTH. Are we ever going to correct the problem, if we do not penalize those providing substandard material?

Mr. VANDER SCHAAF. Well, I think we have to look at it on a case-by-case basis. In some of the cases we have seen, we felt that some penalty, some non-performance penalty was appropriate. We need to tell contractors that they are not going to be allowed to bid on defense contracts or that they are no longer being considered as a quality supplier to the Department of Defense. We have to get some system of quality suppliers. But it runs right into the face of the problem of giving everybody an equal opportunity to bid on government contracts, and that is a very difficult situation in which to draw the line.

Ms. BROWN. Senator, I would like to point out, that at the time the IG was created in the Department of Defense, in 1982, there

were only 80 suspensions and debarments. Last year there were 1,028. Every year we have increased the number of suppliers that have been suspended and debarred. That is because of bringing these kinds of things to the attention of the appropriate officials. There are, I believe, seven different suspensions and debarment boards within the Department. We work with all of them, and bring information to them to be used in making their decisions on suspensions and debarment.

Senator ROTH. Are any of those because of supplying substandard parts?

Ms. BROWN. Well, a great many are because they have provided defective or substandard materials, or have committed other types of offenses to show that they are non-responsible contractors. We get them out of the system. It is an area in which a lot more needs to be done. But we have made, I believe, significant progress in that area, and that needs to be recognized as well.

Mr. VANDER SCHAAF. Those suspensions and debarments are for defects or for product substitution of a criminal nature. In other words, knowingly providing the Department of Defense with a faulty piece of material, in which there was a prosecution for the most part.

The ones I was referring to earlier dealt with non-performing products, in which there is no indication that the manufacturer actually intended to defraud the government. Instead, the quality of production, or the production techniques were not good, or he just used sloppy workmanship or whatever else happened in the process. Those are the ones where we have not used the suspension tool as effectively as we could.

Senator ROTH. With the Chairman's concurrence, I would like to have a report be made about what is going to be done about this at an appropriate time, the end of the year or sometime.

Mr. VANDER SCHAAF. As I say, there is a report and a program working its way through the Department that attempts to address this, in addition to the overall total quality management efforts that are ongoing within the Department.

Senator ROTH. I would like your office, at an appropriate time, to report what action is being taken in these kinds of cases.

Thank you, Mr. Chairman.

Chairman GLENN. Thank you, Senator Roth.

We are going to have to move on. We will have additional questions probably for you. We appreciate it. Obviously, you are into an area which is of great importance to us, and not just to use, but to the American people, because we are trying to make the Defense Department just as efficient as we possibly can and your efforts are certainly a major step in that direction.

Thank you very much.

Ms. BROWN. Thank you.

Chairman GLENN. The next witness, John Layton, Inspector General, Department of Energy.

Mr. Layton, welcome this morning. We look forward to your statement.

**TESTIMONY OF JOHN C. LAYTON, INSPECTOR GENERAL,
DEPARTMENT OF ENERGY**

Mr. LAYTON. Mr. Chairman and members of the Committee, I am pleased to be here to testify on the three issues that you have asked me to comment on.

I would like to submit my full testimony for the record.¹

Chairman GLENN. Your entire statement will be included in the record, without objection.

Mr. LAYTON. Therefore, I will abbreviate my remarks considerably.

Before commenting on these problems, though, I would like to place the three issues in perspective. They are extremely difficult and complex issues that are being surfaced to the public as we sit here.

Secretary Watkins has taken actions independent of those covered by the Inspector General's reports in these areas. Further, the Department is implementing our recommendations dealing with these specific issues. I am referring to the response to our recent reports on contractor indemnification and on compliance with environmental laws.

I will now briefly summarize the three issues you have asked me to comment on and some of my office's recent efforts in these areas. I have submitted a more detailed statement for the record, as I said.

The first issue that you asked me to speak to was environmental compliance problems at DOE. The Department's activities over the years have generated considerable radioactive and hazardous waste. The minimization, clean-up and management of waste material is one of DOE's most important challenges. We have issued several reports in this area. Two of these reports were issued in July 1989.

In addition, we have approximately 14 open investigations looking into various allegations of environmental wrongdoing. Included in these cases are joint investigations with the Environmental Protection Agency and the Federal Bureau of Investigation at DOE facilities.

The second issue that you have asked me to comment on is the implications and practical problems concerning the Department's policy of indemnifying management and operating contractors for all expenses.

Our recent report on indemnification found that the Department's fundamental policy has been, with few exceptions, to completely indemnify its M&O contractors.

The third issue that I would like to speak on is allowable costs for the Department's M&O contractors. We believe that the M&O contract concept, the way it is structured, significantly impacts on the identification of unallowable costs. The two major ways that costs are avoided within the Department are through management oversight of the contractor's work and audits of operations to identify management actions that could prevent wasteful or unnecessary expenditures.

¹ See p. 176.

In the past 2 years alone, our audit reports have identified actions that management could take affecting over \$700 million in M&O contractor expenditures. The Office of Inspector General will continue to place a high priority on work relating to the management, oversight and operations of M&O contractors. The office also will continue to place emphasis on issues relating to environmental compliance at DOE facilities.

Now, this concludes my opening remarks and I would be happy to answer any questions you or the members of the Committee have, sir.

Chairman GLENN. Thank you very much.

Your most recent review of DOE management and operating contracts indicates that five contracts do not even require that costs incurred by DOE contractors be "reasonable." Is there any excuse for having such contract terms? Why is that in there? Are these all old contracts from way back in the super secret days of DOE, or why are they still there?

Mr. LAYTON. I cannot really speak to the historical perspective. I do know that, in the case of one, I am told that President Truman asked the contractor to perform work for the Department of Energy or its predecessor agency at the time, and that his request said that it will be at no profit to the contractor, no loss to the contractor, and at no risk to the contractor, and to this day that principle has stayed with that contractor's operation of the DOE facility.

In the other four contracts, all held by the same contractor, I do not know the logic for that omission of the reasonableness test.

Chairman GLENN. DOE will even pay the penalty for civil or criminal fines imposed on contractors, is that correct?

Mr. LAYTON. Yes, sir.

Chairman GLENN. Is that still being contracted for in the contracts being written now?

Mr. LAYTON. As recent as our report, which was just issued in September, that was the case. I believe that the Secretary, he has responded that he is going to consider our recommendations and I believe that he is attempting to change the relationship, but as I said in my opening remarks, these are complex matters that we are dealing with and simple solutions are not always available, but yes, it still occurs as of today, to the best of my knowledge.

Chairman GLENN. Recently, Rockwell terminated its contract relationship with DOE at Rocky Flats. DOE has announced that EG&G Corporation will assume Rocky Flats' M&O contract, the management and operations contract. Now, that was done without competitive bidding, which is one thing that is questionable to begin with; and, the second is, does this not give an opportunity to start negotiating some of these contracts on a more realistic 1989 basis, instead of what Harry Truman did back after World War II?

Mr. LAYTON. Well, there are two answers to the question. The first is, I support competitive contracting whenever we can do it and, yes, it does give us an opportunity to review, revisit and possibly change the relationship between DOE and its contractors.

I might say that I believe the Rockwell contract did have the reasonableness test in it, and I would assume that that will carry forward to the new contract, with whomever that is.

Chairman GLENN. Why was the new contract not done on competitive bidding, do you know?

Mr. LAYTON. I am not privy to that decision. I read it in the paper Saturday morning and I am not aware of what went on to make that decision, and I am not, in fact, sure that EG&G is the contractor. The way I read it is it will be negotiated.

Chairman GLENN. Do you have any information on whether the new negotiation will have a reasonableness clause, which is one thing that we would like to see in contracting done in this time, not back in post-World War II terms?

Mr. LAYTON. As an Inspector General, I like to speak from facts and you are pushing me out on a limb here. I do not have the facts, but I would assume that the reasonableness clause will carry forward.

Chairman GLENN. All right. Well, I will pull you back in off that limb, then. On page 2 of your testimony, you say, for example, that one site roof replacement contracts originally totaling over \$1.5 million were fraudulently awarded by a procurement supervisor. This and subsequent fraudulent acts resulted in over \$3 million of unnecessary costs being paid by DOE to include \$420,000 of stolen money and materials. Since the supervisor was not determined to be managerial personnel under the terms of the contract, that cost was allowable. Maybe there were technicalities that permitted that to occur, but has anybody gone to jail, out of those three different fraudulent references you make there?

Mr. LAYTON. I believe that nine people have been convicted in that scenario, none of them were DOE employees, several of them were contractor and subcontractor employees, one governmental official not in the United States government, and an employee of another Federal agency was convicted in that case.

The indemnification provisions in the DOE contracts and the way they are interpreted are what preclude the government from collecting or causing the contractor to incur an expense in that situation.

Chairman GLENN. Was the fraud known at the time that the payments were made?

Mr. LAYTON. The frauds were known—I think I need to explain how an M&O contract operates and the way—

Chairman GLENN. Please do.

Mr. LAYTON [continuing]. And the way the contractor gets paid. Management and operating contracts are unlike traditional government contracts, in which the vendor submits an invoice that is processed through some kind of an accounting system where a comparison is made between the goods or services requested and goods and services received, and the voucher approved for payment.

In the management and operating contracts within the Department of Energy, their books and records are integrated into those of the government. They are unique. It is a unique relationship and, therefore, the contractors draw down against that contract contemporaneously with the expenditure of funds. There is no subsequent voucher certification of a particular expenditure, so in this particular case the contractor continues to write payroll checks, write all of their expense checks, and there is no time at which,

contemporaneous with the event or shortly after it, that a voucher is reviewed.

Chairman GLENN. And no check is made when they just put in a—

Mr. LAYTON. We do not draw a check from the Federal Government to reimburse them for a particular voucher, the M&O contractor. I do not want to leave you with the impression that there is no voucher-type examination. That is the reason in my testimony I said there are two important ingredients in a DOE contract, in the auditing function and the management function of DOE that are unlike other government agencies, and that is contract administration is crucial to the success of the M&O concept. The DOE technical representatives have to know what is going on, they have to be around and see what is going on and preclude wasteful practices before they occur.

The second function of contract administration or oversight is performed by my office, and that is we do reviews of the systems to determine if they are appropriately managed, to try to preclude ineffective or inappropriate expenditures before they occur, and once a year we do a review, an accounting review of a cumulative statement provided by the vendor, the M&O contractor, called a voucher accounting for net expenditures accrued, called a VANEA audit. We do those once a year on every M&O contract. But we are looking at total numbers, it is more akin to the audits performed by a certified public accounting firm of a commercial business. It does not look at the nuts and bolts at that time.

Chairman GLENN. So long as the figures were coming out not too far out of line with what has happened in previous years, that could include a high percentage of theft or waste or fraud, and it really would not come to light, is that correct?

Mr. LAYTON. That is correct.

Chairman GLENN. And that is the contracting that we have used all these years?

Mr. LAYTON. As I said, contract administration is critical, that is, it is supposed to be a special relationship between DOE and its M&O contractors. That is the way it was established when these contracts were entered into years ago, long before your time here or mine.

Chairman GLENN. Well, is the new Secretary changing that now?

Mr. LAYTON. The new Secretary, when he arrived, used the words "the culture needs to change." I think you have heard those words.

Chairman GLENN. I have indeed.

Mr. LAYTON. Among the things that he is referring to is reassessing how these relationships work and what is in the best interests of the taxpayer.

Chairman GLENN. You are saying in some of these cases, where we actually knew that there was theft going on, we went ahead and paid these things anyway, is that correct?

Mr. LAYTON. We did not have a choice. We indemnified the contractor, we said the contractor would suffer no loss, and the—

Chairman GLENN. And those contracts have been deemed legal, even to cover situations where we knew there was theft occurring, we would go ahead and pay anyway, is that correct?

Mr. LAYTON. In essence, it is correct. Individuals who are stealing from the Federal Government are subject to civil and criminal penalties. It is the corporate entity that we are speaking of when we talk about at no risk or no loss.

Chairman GLENN. For example, if there was theft en masse, we do not pay any attention, but if it is an individual we will prosecute them?

Mr. LAYTON. I would like to say yes, but I cannot. I have to try to explain, sir. One of the problems with being an Inspector General is you are supposed to deliver the facts. I do not want to sound like an apologist for the system nor—

Chairman GLENN. No, you are trying to work to correct it, I know that.

Mr. LAYTON. I am trying to deliver the facts as I see them. We have tried to consider schemes in our pro-active role of how funds can be diverted from DOE contracts. We have attempted to track those down and we have been successful. The problem is that the contractors are operating DOE-owned, government-owned, facilities, they are the government's assets that are at stake here, not the contractors', and in many cases they have no equity in the system.

As you will note in my testimony, 29 contractors receive award fees out of the 52. The others have either some fixed-fee arrangement or at no profit at all, in 13 cases, I believe it is, so they do not have much at stake, in many instances. And to penalize those that have nothing at stake becomes the dichotomy, how do you effectively implement contracting relationships. And that is why I said in my opening remarks, these are complex and difficult areas that I find myself in as the Inspector General at DOE.

Chairman GLENN. My time is up, and I know we are working on the same side of this. I am not being critical of you, but just one other question, and that is does any other agency or department of government operate with this kind of contracting?

Mr. LAYTON. I think that there is at least one or two in the Department of Defense, and I am not aware of any other agency that uses them.

Chairman GLENN. Sub-agencies out at Defense, or what?

Mr. LAYTON. I am not certain, sir.

Chairman GLENN. Because I cannot believe that, in this day and age, we are still using this kind of contracting, and I would just say publicly here that I think DOE has got to make this a priority in changing this, that is for sure.

Senator Roth?

Senator ROTH. I am not sure, either, that I am following you, but as I understand what you are saying, the system is that you have a contractor representative there generally supervising operations, is that correct?

Mr. LAYTON. Yes, sir.

Senator ROTH. And then you come in and look at the overall, but you do not audit each request for reimbursement for every bill, is that correct, in detail?

Mr. LAYTON. Not exactly, sir. The contracting officer's technical representatives are the people who occupy the operations office where the management and operating contractors exist. They do

not really submit individual invoices for expenditures, the contractors to DOE. They draw down funds to reimburse their checking accounts. That is the integration—

Senator ROTH. The point I was making was that you have the technical people there who are working hand-in-hand with the contractor representative, is that not correct?

Mr. LAYTON. They are providing the Government's oversight of the contract, that is correct.

Senator ROTH. They pretty much approve or disapprove individual actions?

Mr. LAYTON. Yes, sir.

Senator ROTH. So, the Government does have representatives there supervising and approving the actions?

Mr. LAYTON. Yes, sir.

Senator ROTH. It is not as if there is no one there?

Mr. LAYTON. That is right.

Senator ROTH. But then, when it comes to reimbursement, it is not based on individual billing, but on overall—what did you call it?

Mr. LAYTON. It is an annual, we certify annually the expenditures, but they draw down from an account as they expend the funds, the contractors do.

Senator ROTH. As the auditor, do you look at any of those?

Mr. LAYTON. Yes, sir.

Senator ROTH. So, while you do not review each one, you do make, what, an annual audit?

Mr. LAYTON. We do auditing of the systems that provide for those draw-downs and we actually look at the numbers, the dollars.

Senator ROTH. So, the question is whether it would be worthwhile to submit each voucher—now, what would that require in personnel, would that be a much more burdensome job, from your standpoint, or would this be done by internal audit?

Mr. LAYTON. No. I have not considered the scenario that you have just mentioned. I am taking a minute to think about it. I think it would be—to change that system of payment, I believe it would require—and I am a little out on the limb here again—I believe it would require a change to the style of contracting that now exists, that the books and records could no longer be integrated.

And I might point out one of the unique features of a management and operations contractor is that they do have to have, the contractor has to have a separate set of books and records for our facility. They are not related to the rest of the corporation's books, so we do not have—

Senator ROTH. Are those books approved as part—

Mr. LAYTON. They become a part of the DOE books and records.

Senator ROTH. You review—

Mr. LAYTON. We audit those.

Senator ROTH. You audit those, in the sense you approve them?

Mr. LAYTON. If I could just continue with that one step further, the fact that those books and records only represent activities taking place at a DOE facility, that eliminates some of the kinds of frauds that I have seen at both NASA and the other place where I was the Inspector General, and those are cost distribution and cost allocation between commercial work and government work, be-

cause we only have one kind of work, so every expense that is incurred, whether it is fraudulent or not or whether it is for purposes we do not want it for, is still done on the government books and records and does not enhance the corporate posture, financial posture. For example, you cannot offload a loss from one contract to a DOE contract, because we only have DOE activity on those books.

Senator ROTH. Only the costs incurred under that contract for that facility?

Mr. LAYTON. That is correct, and that is—

Senator ROTH. Let me ask a difficult question. You are familiar with the process. Would you say it is adequate, good, superior, inadequate? I mean, a CPA, when they audit a commercial business at the end of the year, they have to certify that it is in accordance with sound accounting practices.

Mr. LAYTON. We certify that the books and records generally reflect accurately the financial condition of what took place. There is room for improvement. We are aware, I am aware that we can do a lot more to try to determine that funds invested in DOE M&O contracts are expended for the purpose that we want them expended for, to ensure that the taxpayer gets his or her money's worth.

Senator ROTH. Let me go to the public law creating the I.G. and ask you this question: Are there any significant problems, abuses and deficiencies relating to the administration of programs in operation? If so, what are they? I know we have gone over some.

Mr. LAYTON. Well, I think in my opening remarks that I have cited that we have tremendous environmental problems at the Department of Energy and—

Senator ROTH. I understand that. How about financially, the records?

Mr. LAYTON. I think overall that the Department of Energy financial systems are probably superior to many, and they have made tremendous strides towards consolidation of the financial systems in the Department of Energy.

Senator ROTH. Let me ask you this question: You issue semi-annual reports. Have you ever had to issue 7-day letters?

Mr. LAYTON. No, sir.

Senator ROTH. Now, have there been any oversight hearings before today of the semi-annual reports by any committee or subcommittee?

Mr. LAYTON. We have had congressional committees that have held hearings based on the work of my office. Whether you call them oversight or not, we have been the stimulus for other hearings.

Senator ROTH. How about on the basis of your semi-annual reports?

Mr. LAYTON. The information has come from the semi-annual reports and then we have provided—for example, the semi-annual reports show in synopsis form what we found and then we have provided the supporting material for the hearing, on occasion.

Senator ROTH. Well, I will not ask you to grade the caliber of those oversight hearings.

That is all the questions I have at the moment, Mr. Chairman. Chairman GLENN. Thank you. I just have one follow-up here, and that is on this fraudulent awards and so on. You indicate there is a

DOE representative at these plants. Does that person check and then sign off on the submission of bills from the contractor before those are submitted for payment?

Mr. LAYTON. To the best of my knowledge, not in the way I believe your question implies, no, sir, because there is not a specific bill for each transaction.

Chairman GLENN. No, but that person at the plant would know what materials are coming in, what is going on, the number of people there. He would have a better shake, it seems to me, at knowing whether there was fraud going on in the submission of bills, because if the contractor submits his bills and then you come back at the end of the year and you audit those, as long as his books showed a legal expenditure, you would have no way of knowing whether it was fraudulent or not. It seems to me that the person at the plant would be required to verify that, yes, the money was spent for legitimate purposes of the plant, so that we do not wind up, as you have on page 2, with contracts in the millions being fraudulently awarded.

The DOE rep at the plant does not sign off on the submission of expenditures, we just take the contractor's word for that and pay the bill, is that right?

Mr. LAYTON. That is an oversimplification, but essentially, yes. Now, that is why in my opening remarks and in my testimony I said contract administration is so important to the Department of Energy and the way it does business. The representatives at the operations office are the contract administrators for DOE and they do observe what is going on, and I am sure—I have not done an audit that is completed, I should say, I have not completed an audit, but they are attempting to insure that the funds are spent for the purposes they were intended.

I do not want to be too far out on a limb here and give them credit for something I have not done an audit to prove, but I believe that is what they are doing and I have talked to the operations office managers and they are concerned that the funds be spent for the purposes they are intended. That does not mean, though, that we are not getting bills for services that were not rendered.

Chairman GLENN. Okay. Just one other question. How many DOE representatives are there at the average site? It has been my impression that there are one or two, at best, maybe some secretarial help, but that is about it.

Mr. LAYTON. That is the impression we have, and I have had that, too. I think you and I are familiar with Fernald, and I think there are about 16—

Chairman GLENN. That is what I was referring to.

Mr. LAYTON [continuing]. Sixteen people there, but there are about 5,000 DOE employees at the operations offices, and so a large operations office may have 800 people, there may be 300 to 800 people at an operations office, but not all of those people are doing contract administration, and that is where the need for technical expertise comes in. Those operations offices need to be staffed by people who understand how to run a reactor or how to clean up waste or how to make a technical system work.

Chairman GLENN. Okay. That is all I have.

Senator ROTH. Mr. Chairman?

Chairman GLENN. Senator Roth, go ahead.

Senator ROTH. Yes, because I think it is important. As I understand the system, for better or worse, it is that the government, the Department of Energy hires the contractor to provide his management services, and that as part of that process the contracting officer or his representative approves the procedures, including the accounting procedures.

Mr. LAYTON. Yes, sir.

Senator ROTH. And periodically, you, as the auditor, audit to insure that the system is being followed and that it is working.

Mr. LAYTON. Yes.

Senator ROTH. But admittedly, there could be false claims. I mean a private contractor has employees who steal, just like the government does. But the idea is that perhaps overall—and I am not sure this is a fact, but my understanding of the theory is that—this may be a more reasonable basis of doing business than having the government approve every single voucher and bill. If you start going that way, then you are going to have to triple—I have no idea, but you have to have a much larger personnel there, and even that will not guarantee that there will not be some theft. Is that not the principle?

Mr. LAYTON. You have explained it exactly as I understand it to be, that is an accurate rendition, that we buy management services from a contractor and we have their systems in place and I, as the auditor, attempt to ensure that those systems are as they have described them to be and that they have adequate internal controls.

Chairman GLENN. We are on another vote and I am going to run and vote and see if I can get back.

Senator ROTH [presiding]. I think it is important to understand that difference, because I think this can be a very effective way of contracting, if properly administered. I mean, if you want to try to check every single set, you are going to spend millions, if not billions of dollars, in review and auditing, so that I think it is important that we distinguish what is intended here. Whether it is working right or wrong is another question. Let me ask you that question, if, generally speaking, you would grade it satisfactory? I am talking about the financial records. Let me ask you how would you grade it?

Mr. LAYTON. I have difficulty with placing it on a scale. I can say we have taken slices of the system and reported on it.

Senator ROTH. Let me go back to the CPA, the whole purpose of the audit. The CPA once a year goes into a firm and goes through their process and says that they are in keeping with acceptable accounting records. Would you be willing to sign that kind of a statement?

Mr. LAYTON. Well, I do, I sign a VENEIA every year, or my staff does, that says the books and records reasonably reflect the condition of the company.

Senator ROTH. Now, that does not mean that there is not going to be some fraud there, does it?

Mr. LAYTON. That is right, or that there are not problems. There are opportunities for improvement, and I think we have demonstrated some of those, that the general health of—

Senator ROTH. The only reason I am trying to stress this is I do not want to throw this way of doing business out if it is working well. Because, frankly, we can hire 10,000 auditors in the Pentagon and everywhere else if we want to go over every detail, but I question whether that is in the interests of the taxpayer.

Mr. LAYTON. I think that is a responsible position to take. We need to look at it and discuss it and consider the options, are the options worse than what we have.

Senator ROTH. Thank you, Mr. Layton. We appreciate your testimony.

Mr. LAYTON. Thank you.

Senator ROTH. Senator Kohl?

Senator KOHL [presiding]. Thank you.

Mr. Layton, it appears from your report that in some instances where DOE has required a standard of reasonableness in its indemnification agreements, it has limited that standard to actions taken only by the contractor's top corporate officers, is that right?

Mr. LAYTON. Yes, sir.

Senator KOHL. Well, wouldn't this seem to eliminate any incentive for good management practices? Would this not discourage, for example, the company's top officers from getting involved in overseeing operations and keeping a close eye on what is happening? That way, when things go wrong, all he has to say is, "I didn't know anything about it?" Isn't that the way the system, in fact, does work?

Mr. LAYTON. I do not see a financial incentive for the corporation to exercise control over costs that are incurred, that is correct.

Senator KOHL. Well, there is not anyone in this room who would not understand what a foolish way it is for us, as a government, to write those kinds of contracts. You do not have to be a lawyer. I just touched on it, and everybody here understands it in a minute, I am sure, so why would we do that?

Mr. LAYTON. I think Senator Roth was making the point, and he articulated it well, that there are other controls in the system, that is, the Department of Energy has bought a contractor system of doing business in that they do not have other work at that site except DOE sponsored activities. All funds that are flowing through that location are for the purpose of doing DOE work, and it is in the distribution of costs where we find most of the illegal activity.

I might point out also that, in way of incentives, we have opportunity for civil and criminal penalties for individuals and there is Price-Anderson that does provide for civil and criminal penalties against the contractor, but, generally speaking, the financial incentives are not there. And I might also point out that the rewards are relatively low, compared to the rest of the industry, that is, that the payments made to the contractors are either no profit or relatively low award fee.

Senator KOHL. But it is true, is it not, that the contractor has no risk at all? He is reimbursed for every cost?

Mr. LAYTON. Generally speaking.

Senator KOHL. What is his down side?

Mr. LAYTON. His good name, good reputation.

Senator KOHL. But most people in business, when they enter into a business relationship and interaction that takes place in the negotiation of that relationship, both sides have some down side and the down side is usually financial, because that is what business is all about. What is their financial down side?

Mr. LAYTON. As I said, I do not see a financial incentive in it for the contractor. They have a small award fee. Now, speaking of award fees, Admiral Watkins has put a lot of emphasis on award fees. He has spoken of changing the culture and providing a carrot and stick.

Senator KOHL. I am sorry, I have to recess the hearing, folks, because I am the only one here but I have to vote, too. I am just going to bring up some of the same problems with respect to damage to machinery and abuse of property, things of that sort. It seems to me that there are not adequate safeguards to handle those problems written into our contracts with these business establishments. It is really a shame. I think it is pretty clear, which, of course, leaves an awful lot to be done and that is why you are here.

Mr. LAYTON. Thank you.

Senator KOHL. We will stand in recess.

[Short recess.]

Chairman GLENN [presiding]. The hearing will be in order again.

We do have to move along and, Mr. Layton, we will appreciate your response to any additional questions we might want to submit to you for the record. We appreciate your testimony this morning and thank you very much.

Mr. LAYTON. Yes, sir.

Chairman GLENN. The next witness is Bill Colvin, Inspector General of the National Aeronautics and Space Administration, NASA.

Mr. Colvin, we welcome you here this morning and look forward to your testimony.

TESTIMONY OF BILL D. COLVIN, INSPECTOR GENERAL, NATIONAL AERONAUTICS AND SPACE ADMINISTRATION ¹

Mr. COLVIN. Good morning, Mr. Chairman. I am pleased to be here and I thank you for the opportunity to appear before you today.

I have submitted a statement for the record which identifies the areas of concern that I have regarding NASA's programs and operations. I would like to take a few minutes to expand on those concerns as they relate specifically to the areas of contract management, safety and quality assurance and audit follow-up.

Approximately 88 percent of NASA's budget is allocated to procurement. Accordingly, the Inspector General's Office has issued several reports included under the contract management function. These include fee awards, labor rates, spares acquisition, competition in contracting, and, more recently, subcontract management.

¹ See p. 197 for Mr. Colvin's prepared statement.

We have issued three center level reports on subcontract management and will soon issue a consolidated report which will disclose that prime contractor actions in selecting, negotiating and awarding subcontracts and NASA's review of these actions are not sufficient to insure reasonable prices and to promote subcontract competition; that prime contractors were paid an estimated \$22 million in excess costs and profits; that 81 percent of the subcontracts reviewed were awarded without competition, that 33 percent of the subcontracts were overpriced, and that 12 percent had profits exceeding 100 percent, ranging to almost 300 percent.

We made many recommendations to management to correct these deficiencies—all agreed to, including the pursuit of civil servants to oversee this critical function. We are also pursuing these issues under the investigative program, looking into defective pricing issues.

With NASA's increased emphasis on safety and quality assurance, we have likewise been active in this area. I am particularly pleased with our audit of aerospace fasteners. This audit revealed that fastener certifications were unsupported by test results. Untested or under-tested fasteners were installed in flight hardware. There was no lot traceability of fastener products. Current practices of disposing of uncertifiable fasteners did not preclude their false recertification and resale to the government.

Investigations in this area have resulted in seven indictments and five convictions, with several investigations ongoing. This was a government-wide deficiency, not just a NASA problem, and these deficiencies have obvious safety implications. Our audit resulted in testimony in support of new legislation to strengthen the internal controls in this industry.

We have now initiated an audit of the electronic component certifications and early results indicate that similar conditions exist which will impact the safety and the quality assurance areas.

The last area I would like to discuss is audit follow-up. This is an important management responsibility for insuring corrective action and providing for an early warning system in identifying significant weaknesses. The absence of a formal audit follow-up system has been reported as a material weakness in each of the last three reports to the President under the requirements of the Federal Managers Financial Integrity Act.

The need to develop and implement an adequate follow-up system in NASA has been a long outstanding issue that requires immediate management attention. I consider this to continue to be a material weakness, one for which management must accept responsibility if an early warning system is to be effective.

Up until January of this year, I conducted 100 percent follow-up on IG recommendations. In my opinion, there are many other reports, such as GAO, DCAA, internal control reviews, and others that must be included if this process is to be effective.

Other issues previously discussed, fasteners and subcontract management, have also been included in annual FMFIA reports. These material weaknesses require greater management commitment.

The new Administrator, Admiral Truly, and Deputy Administrator, Mr. Thompson, have taken an active and a positive interest in

these issues and the implementation of the FMFIA requirements. I anticipate that NASA's progress will continue.

This concludes my oral remarks, Mr. Chairman. Thank you, and I will be glad to answer any questions you may have.

Chairman GLENN. Thank you very much.

Those are rather startling figures that you put out in your supplemental statement. Your entire statement you submitted earlier will be included in the record, in addition to the shorter testimony you gave.

I believe some of those figures were not in the original, is that correct?

Mr. COLVIN. That is correct.

Chairman GLENN. Those are startling figures to me, and in your original testimony you state that, due to workload, your investigative cases are open an average of nearly one year from start to closing, and that, in excess of 80 percent of these matters are criminal in nature.

Mr. COLVIN. Yes, sir.

Chairman GLENN. How many investigations would that be?

Mr. COLVIN. We are carrying, at any given point in time right now, approximately 300 active investigations. We have a backlog of approximately 300 investigations that have been screened, identified and are waiting to be worked.

Chairman GLENN. And 240 or 250 of those cases would be criminal cases that you are bringing, is that correct?

Mr. COLVIN. That is right, 85 percent will be criminal cases.

Chairman GLENN. The other figures you gave were that 81 percent of the subcontracts were awarded without competition, prime contracts—these are the primes, the big ones—

Mr. COLVIN. No, these are subcontractors.

Chairman GLENN [continuing]. Were paid \$22 million in excess costs and profits.

Mr. COLVIN. These were subcontractors.

Chairman GLENN. They are subcontractors?

Mr. COLVIN. It is subcontracting work that we looked at.

Chairman GLENN. You had the prime contractors on your statement here, the prime contractors were paid—does that mean that is supposed to be subs?

Mr. COLVIN. I would have to look at the statement, Senator—

Chairman GLENN. It is on the second page of your supplemental statement there this morning, you had that the prime contractors were paid an estimated \$22 million in excess costs and profits, on the second page of your supplemental statement.

Mr. COLVIN. That would be true, then, it flowed through the prime contractors.

Chairman GLENN. Fine. Thirty-three percent of subcontracts were overpriced, 12 percent had profits exceeding 100 percent, ranging to almost 300. Are we getting any of that back, now that you have uncovered it?

Mr. COLVIN. Certainly, we have made recommendations to not only recover several million dollars in that area, but also to prevent that from occurring in the future.

Chairman GLENN. These are mainly percentages here. Do we have any idea how that translates into actual dollars?

Mr. COLVIN. I believe I do have that information, I think in the neighborhood—it is in the millions. I can submit an exact figure for the record.

Chairman GLENN. Would you do that, please? We would like to have that figure for the record, if we could.

Mr. COLVIN. I will.

[The information referred to follows:]

RECOMMENDED AND ACTUAL RECOVERIES AS OF SEPTEMBER 30, 1989

NASA Center	Recommended recoveries (in millions)	Actual ¹ recoveries
Goddard Space Flight Center.....	\$2.2	\$279,000
Marshall Space Flight Center.....	8.8	721,000
Johnson Space Center.....	6.9	348,000
Total.....	17.9	1,348,000

¹ NASA management is continuing its efforts to recover additional funds.

Chairman GLENN. You mentioned that you did 100 percent audit follow-up until January of this year. Are you not doing 100 percent follow-up now, and, if not, why?

Mr. COLVIN. Senator, audit follow-up is clearly a management function. In the past, I have done 100 percent audit follow-up of only the IG audits. That required for me to dedicate two or three of my audit resources to doing follow-up. That detracted from my ability to do audit work and, as a result of that, I had an agreement with management that they would implement an audit follow-up system. I terminated my function of doing the audit follow-up as of January.

Now, I have not eliminated myself entirely from that process. Those that I consider significant, those recommendations that I consider significant I am still in the concurrence loop on before those recommendations go forward.

Chairman GLENN. Is management following up in all these areas that you formerly did the work on?

Mr. COLVIN. My statement was that I still consider this a material weakness. Management is moving, but not as quickly as I would like to see it done.

Chairman GLENN. Where you did 100 percent of the follow-up before on this, can you give us an estimate as to what percent management is now following up on?

Mr. COLVIN. The IG reports, I think that they are following up probably 100 percent.

Chairman GLENN. A hundred percent. Okay.

Your testimony also states that you are only able to audit about 4 percent of the total internal audit universe each year. How do you determine that percentage and what percentage of IG resources is devoted to reviewing the procurement activities alone?

Mr. COLVIN. The determination of the percentage of the audit universe that we are able to cover is based upon our establishing an audit universe which is a normal audit planning tool that is used throughout the government; based upon that universe, we can divide that into seven accessible units and then identify the work-

load that is required to provide audit oversight in each of those accessible units. Based on that, then, I have about a 22-year cycle. That means that I can at any point in time audit only about 4 percent of the total universe.

I have tried to prioritize our work and look at what we would consider to be the highest priority or priority one level efforts. In doing that, I can reduce that to about a 9-year cycle of the priority one work, which means that I can cover about 11 percent then of the priority one effort.

Chairman GLENN. I know that you cannot do 100 percent on this out of the IG's office, nor should you be expected to do that, but how many people do you have?

Mr. COLVIN. I have 136 FTE's, 10 part-time, FTE's full-time equivalent, so 136 staff. Of that—

Chairman GLENN. I know you would like to have a cast of thousands under your direction to do this kind of work, obviously. Everyone would. But let us say you increased your resources by a third, let us say you had another 50 investigators or auditors, I know it would materially aid you, but we also have to look at what we are getting back, the cost effectiveness of additional auditors and inspectors. I would anticipate from the figures you have given that we would get far more than the cost back in savings if we went that route.

Mr. COLVIN. I would expect that we would be able to continue to pay for our existence with that kind of an increase. You asked about 50 auditors or 50 investigators. Certainly, 50 investigators would give me the ability to turn that 300 backlog over in about one year, so I could work off that inventory in about one year.

The audit side of the house, certainly an additional 50 auditors would give me the ability to reduce that 22-year cycle down to about a 13-year cycle or—

Chairman GLENN. From reading your figures, though, I think we just have to do that, because, I read again, 81 percent of the sub-contracts reviewed were work without competition, 33 percent were overpriced, 12 percent had profits exceeding 100 percent, going up, some of them, 300 percent, 80 percent of these matters were criminal in nature. It would almost appear that a lot of the contractors are looking at NASA as a real prime target for getting away with a lot of things that they should not get away with.

Mr. COLVIN. Well, certainly NASA is a contracting agency, 88 percent of its budget is out there.

Chairman GLENN. Which leads me into the next question, and that is, as NASA management said in a letter to OMB Director Darman a short time ago, they are "being pressed to convert more and more critical functions to performance by contractors." Do you feel that they do not have the capability in-house to do these things and they really are being pushed in that direction, and what does this mean as far as your ability to monitor all these things?

Mr. COLVIN. Senator, the agency has looked on several occasions at what more can it contract out. My office has been examined in that process. I have been able to successfully defend that one so far. The weaknesses that I have seen, particularly in the subcontract management area, is that there is not sufficient civil servant

oversight to provide the government a reasonable level of assurance.

Chairman GLENN. Okay. This is an area we are going to want to follow up on with you also, Mr. Colvin. I think we are going to have to move along here. We have another vote on and I am not going to go until I hope somebody comes back here, but thank you for your testimony. I want you to follow up here. This is excellent testimony. The figures are startling, in a negative sort of way, and obviously we need to do much more in this area.

Thank you very much.

Mr. COLVIN. Thank you for the opportunity.

Chairman GLENN. Our next witness is Sherman Funk, Inspector General, Department of State.

Mr. Funk, proceed with your testimony this morning, and I hope that someone else comes back here before I have to leave when the five lights and the buzzer go up in a few minutes. I will have to leave to go vote and then get back. I hate to have a truncated hearing like this, but we do not have any choice this morning.

Mr. Funk is Inspector General of the Department of State. I mentioned at least one area that he has been involved with in my opening statement this morning.

Mr. Funk, we welcome you and look forward to your statement.

TESTIMONY OF SHERMAN M. FUNK, INSPECTOR GENERAL, DEPARTMENT OF STATE

Mr. FUNK. Thank you, Senator. With your permission, I would like to insert my full statement in the record.¹

Chairman GLENN. It will be included in its entirety.

Mr. FUNK. It has been a long morning. I would like to go and just hit the highlights of my statement, rather than read it.

I am going to discuss two things, both the State Department and my work as the Vice Chairman of the President's Council on Efficiency and Integrity. Let me get first to the State issues. I would note that these are deeply imbedded in the structure and the culture of the Department, many involve other agencies, and all of them are very thorny.

Let me begin with visa or passport issues. We own in the Department of State papers that are some of the most valuable in the world right now. I am talking about visas, visa stamps and the passports. The going price for a visa is anywhere from \$4,000 to \$10,000 a pop. Passports go for considerably more.

One of my investigators operating undercover not long ago was flatly offered \$40,000 for five passports. I was told yesterday that in another investigation somebody was waving around the figure of \$60,000 for a passport. It is nice in a way to be able to—

Chairman GLENN. Let me interrupt right there, if I might. From what source does that come, mainly? What nationality is wanting that kind of access?

Mr. FUNK. These are in the Far East, sir.

Chairman GLENN. The Far East?

Mr. FUNK. Yes, sir.

¹ See p. 200.

It is nice to be able to say that people want to pay so much to get into this country, they are willing to kick off that kind of money, but I must say that it has alarming implications, because most of the work overseas in our embassies and consulates in the visa area, most of it is done by foreign service nationals. Typically, these are paid according to the prevailing wage scales, which in many countries is low, and that makes them vulnerable. When they are vulnerable then we have difficulties in bribes, given the amount of money involved, not unlike drugs, where the money is so great they can buy easily somebody with a low pay rate.

We have had many investigations going on in this area. Just in the past month alone, we completed a long investigation in Bangkok, which resulted in virtually wiping out the entire foreign national employee section in the visa area. In Tel Aviv, we had another long investigation, working jointly with the diplomatic security people and the Israeli national police, and there we have arrested 6 FSN's from the embassy, and the local police picked up 16 other Israelis. And those are just two recent cases.

We also issued an audit report which discusses this whole area and calls for considerably tighter controls, and points out some of the vulnerabilities which need those controls.

Let me go back for a moment, sir, to our meeting with the President right after he got in office, at the end of his first week in office. He met with the IG's and he told us that he badly needs us to provide some kind of early warning system. What he was afraid of is that we would be faced yet again with something like the savings and loan crisis, something like the nuclear plant problem, the certification problems of the nuclear plants.

Chairman GLENN. Mr. Funk, I am going to have to interrupt. I really hate to do this, because we have had a poor way of running things this morning here, but I am going to have to go vote. If anyone else comes back here before I do, they can take over.

Mr. FUNK. We are each paid to do our job, sir.

Chairman GLENN. Can you come back on Tuesday?

Mr. FUNK. No, sir, I cannot. It is my first vacation in over a year and my wife will divorce me and I cannot afford a divorce, sir. [Laughter.]

Chairman GLENN. We cannot interfere with things like that, that is for sure.

I will just have to temporarily recess and get back as fast as I can or until someone else gets back. I hate to do this, but I must.

[Short recess.]

Senator Roth [presiding]. The Committee will come to order.

Mr. Funk, I apologize for not being here earlier, but the Chairman and I are trying to play alternates in our voting. I take it you have given your testimony, is that correct?

Mr. FUNK. No, I have just started, sir.

Senator ROTH. Please proceed.

Mr. FUNK. I was going through it very quickly and hitting the once-over and hoping we can spend more time on questions.

Senator ROTH. Yes. Please proceed.

Mr. FUNK. I was just mentioning that when we met with the President, shortly after his inauguration, he asked us to give heads-up on the things that we saw coming downstream that might

be budget busters that we had not planned on, similar to the S&L crisis and the nuclear plants.

As soon as I heard that, I thought of one problem in the Department of State, and that is the whole area of repair and maintenance of our real property facilities overseas, and I indeed think that this is the kind of message we should send in this area, because we are talking about 2,100 properties, the average age of which is 22 years, the average cost of which is sometimes incalculable. How do you measure our compound in Tokyo? Some people say that alone is worth a billion dollars, but it is hard to put an appraisal on something like that. But we have an awful lot of money invested in real estate over the world, much of it deteriorating badly.

I am still concerned with the problem of security of our people, our facilities, and our information overseas. As I noted in my testimony, I established a new office, at Secretary Shultz's request on January 1st—Secretary Baker reaffirmed it—an Office of Security Oversight. I am now performing for the Department and for other agencies a very comprehensive monitoring of all of the security problems in our embassies and our consular posts. The good news here is that we have made enormous advances in the past few years, enormous advances, that, frankly, many who are familiar with the area never thought possible. But the bad news is that we have a long, long way to go as yet. We still have major vulnerabilities. My survey teams that go out, are multi-talented, multi-agency teams which indeed find that we have continuing vulnerabilities.

I cannot go into details of these in an open hearing, but they are somewhat alarming, and I must also say that now they are being addressed. Some are resource measures and the dollars simply are not there.

But the next problem has a very sharp impact on security and that is something simple to state and difficult to correct. We have too darn many people overseas. Our posts have grown, they have grown over the years. Where 20 years ago, we had a very small sleepy post of five, six, seven people, we may now have 500 people there, counting guards and counting the support personnel.

To give you an example, I cite—

Senator ROTH. Where was that again, Mr. Funk?

Mr. FUNK. This is one of our posts, one post overseas.

Senator ROTH. I see.

Mr. FUNK. In Frankfurt, which is not an embassy, it is a consular, in Frankfurt there are 36 agencies, U.S. agencies that are stationed in Frankfurt, and that was as of last count. I expect it has gone up. Remember, every time an American citizen is stationed overseas, we are paying an absolute minimum of \$100,000 plus salary to support that person. In many cases, it is considerably more. In a place like Abidjan, it is about a quarter of a million dollars a person.

So, this is something that we are looking at very closely. The Department is setting up various task forces to see if we can get a handle on it, but it is a very obdurate problem to solve, because, number one, the agencies have their own pipeline here on the Hill, they have their own pipeline to various constituencies, and the

State Department has never been very good at that kind of fighting and we tend to lose when it gets down to bare knuckles.

The fact of the matter is that we are reaching the stage where we are being priced out of existence and we have to be very careful about that. I visited one post, Senator, in East Africa, that had no more than 12 reporting officers. Our only purpose for being there was for these reporting officers, our only *raison d'être*, and yet that post has a total of almost 1,000 people employed on the payroll to support the cutting edge of those reporting officers, and that gets to be very expensive, even assuming that the local nationals there are working at very low pay.

Another area that is giving us some concern is the area of narcotics eradication and interdiction overseas, particularly in Peru and Bolivia. I testified on this area not long ago here on the Senate side, in the Foreign Relations Committee. I soon will be releasing a report on the Golden Triangle in Southeast Asia. I believe the situation there is slightly better than in Peru and Bolivia and Colombia, but I am still gloomy. A lot of work is going into it. As you know, we do not have the results as yet of the enhanced program that Mr. Bennett has set up, in which substantial monies go to overseas eradication, enforcement and interdiction. It is early days yet to say what the result of this will be. A lot of good work, a lot of courage, unbelievable courage, by some of our people involved in the bush, but I must say that the prognosis is not good.

I noted in my statement that the State Department has within the past year joined the Major Systems Acquisition Club. State, sir, has never been a major procuring department. We are essentially a people department, paying for the people overseas and the support thereof, and we have just a few grant programs. But now we are getting into areas where we have a mammoth computer system, we are buying one of the world's biggest telecommunications systems, and we are developing and about to buy the various pieces of, again, a gigantic worldwide information system.

What bothers me, as an Inspector General, is that the State Department is not geared up to address the implications of that kind of purchase. We do not have the systems management setup to review all parts of it, and, above all, I am not at all sure that we do a good job in the critical requirements determination early on.

My own experience has been, unless you have a rock-solid requirement, everything else after that may be in trouble. So, we are looking at this very hard. I think that some of the systems where we have been working with the Department, there has been very substantial growth in terms of better management, but the fact of the matter is that State is now penetrating a rather murky area in terms of the capabilities and culture of the Department.

Speaking of culture—

Senator ROTH. Let me ask a question there, if I might, Mr. Funk. Mr. FUNK. Surely.

Senator ROTH. Is that system strictly for the State Department, or is that government-wide, or what—the communications system?

Mr. FUNK. Overseas, nothing we do is only for the State Department, Senator, because we support all the other—except for the military commands—everything else comes under the aegis of an ambassador. So everything in terms of communications, in terms of

information spread, sooner or later comes through the State Department. Otherwise, we have duplication that becomes untenable.

Senator ROTH. That is what I was curious about.

Mr. FUNK. To be sure, there is duplication now. You can go into East Africa and you will find a warehouse with all the capabilities and facilities needed to sustain the warehouse. You go into a motor pool, which would make any motor pool here look sick, because we have to do everything over there, building a car from scratch sometimes, because you cannot rely upon local repair. Then you walk half a mile down or drive a half a mile and you find another warehouse and another motor pool for other agencies, like AID, for example. I find, as a taxpayer, that very bothersome.

Now, there are specific reasons in each case which can be given in argument. But I sit back and ask, can I justify, as a taxpayer, let alone as Inspector General, can I justify Uncle Sam kicking in all this money to have what, in effect, are duplicative facilities? We are taking a very hard look at that now and I am working closely with the AID Inspector General on that kind of activity.

My last point on the difficulties in the Department is perhaps the most thorny of all, and that is the Foreign Service Personnel System. This cuts to the very heart of how the Department operates.

I have to tell you that the Department turns out some stunningly capable people. We turn out Foreign Service Officers who have courage, have great competence, and who perform in places sometimes of vast difficulty. If I can just give you the kind of person I am talking about—I do not mean to particularize—my former Deputy GI has been Ambassador to Kuwait, before that Nicaragua, and the next mission he is going to shortly, assuming the Senate goes along, will be Peru—all three of them danger posts. These are the kind of people, when I look at them, they take my breath away, they are so good. I feel somewhat like the admiral in the movie "The Bridges of Toko Ri," when he saw these planes going off the aircraft carrier and he said, "My God, what do we do to deserve people like that?" That is one side of the coin, and it is a side of the coin I am very conscious of and very proud of.

But the other side is that the Department's personnel system, although it kicks up people like that, generally does not work very well. It generally does not work very well. To be sure, we staff our embassies, we staff our consulates, we have basic training programs that are provided at a very high cost. But, in too many cases, we force some of our very talented people to leave early in the game, and, above all, the system does not assure that we have our most qualified and trained people where we need them, in the right place at the right time. This is a very complex area, but I just want you to know we are looking at it. There have been several commissions and studies appointed in this area. The current administration, Jim Baker, Larry Eagleburger, and Ivan Selin are looking very hard at this also, and I suspect there are going to be substantial changes, for the better, I hope.

I have to tell you that, as an IG, I came to State expecting the worst, and one of the things I expected was to have to fight tooth, nail and claw for every recommendation. It has been an enormous-

ly pleasant surprise to me that the Department has been so responsive.

I suspect this resulted in large part from the fear of the unknown. I was the first non-Foreign Service Officer ever to become IG of State and, by law, of course, I cannot be a Foreign Service Officer. So, there was some discontent, wariness, more than that, fear. That did not bother me but I thought it would complicate matters, in terms of getting our recommendations responded to. That has not happened. To my delight, I have never had such a good arrangement, particularly after 6 years at Commerce, where very often I had to fight for recommendations. At State, I am getting excellent responsiveness.

I am often asked why it is so responsive. After all, I have been there 2 years, it cannot be just fear any more. One reason is that the very culture of the Department, the Department of State, is very quick to accept criticism. It is even quicker to develop some kind of mutually agreeable action. After all, we are talking about professional diplomats. But the trouble is, after they agree to an action, they very stubbornly resist doing anything about it, and that gives me some concern.

I had all of these acceptances and I was worried. Was I really getting the action at the far end of the cycle? Without the action, I am playing games. We are getting the action. We are indeed getting the action. I always cover my bets, being a cynical IG, so we have a very extensive compliance mechanism. We track all the recommendations. The Department now, for the new management report required by law, is using our system and they are dedicating people to work with it, but basically I do it myself.

We run compliance teams. Forty percent of my inspections are followed up 6 to 15 months afterward by a compliance team, which goes to that post and essentially asks, did you do what you said you did. If they do not, that is a misstatement and we take it very seriously and so does the Department.

With the kind of response I was getting, I think I can say that I already had satisfactory compliance relations before the new team came in. Now, I send—this is an actual occurrence—I sent a recommendation up, a personal recommendation where this is warranted, to a high level of the Department. The very next day, the very next day, I got my memo back with a note scrawled on it saying "done." It did not say "accepted," it did not say "we will do it." It said "done." I cannot complain when I get that kind of service. It helps me considerably, it helps my staff, and it sends a message throughout the Department.

Let me turn now to some issues of great concern to the IG community. First, I should like to discuss retention of the IG's. There was a lot of uneasiness in the IG community. Months and months passed after the President's inauguration, and no word was given to the IG's about their status. I have to tell you, I think the bottom line is that much of this apprehension was not warranted. There have not been massive dismissals, we certainly have not had what occurred on January 20, 1981. In fact, we were told early on that there would be no massive dismissal.

We were also told that the White House would be speaking to each of the Cabinet Secretaries about retention of the incumbent

IG. We do not know who made these calls, but they apparently were made and, as Vice Chair of the PCIE, I was briefed on them. When the calls were made, my only concern was to make sure that they advised the Cabinet Secretaries of the presumption that, unless there was something specific and sound to the contrary, the incumbent IG would be retained. We did not want, I do not think any of us wanted, any perception of politicization. In fact, I was told that this message was delivered; I understand when the White House did call, they assured each Cabinet Secretary that partisanship could not be a reason for removal.

If matters had moved quickly then, there would be no problem today. But matters did not move quickly. The process went on for many months. I have to tell you that the appointment process for everybody, as you know, has not been marked by blazing speed, so it was not just the IG's. But the IG's being in kind of a funny position, feeling under the gun, quite a number felt that this was making their life a bit too difficult.

In my own case, to show the kind of Alice in the Looking Glass nature of this thing, I was advised informally last January that Secretary Baker wanted me to go. The first "official" word I heard since then, however, was just a few days ago, when The Washington Post said I was going to stay on. I do not think this is the right way of running such things, and I hope something will be done for future turnovers to prevent it. But I think there is a better way that would preclude the problem altogether.

A year ago, I testified before Government Ops that I strongly believed in a set term of office, that there should be a fixed term of office for the IG's. I recommended a term of 7 years, for two reasons. One, it would overlap the quadrennial election, thus insulating the IGs from associated pressures. Two, nobody should be an IG in any one agency for too long.

My rationale was, first of all, you get jaded. You do not want an IG who is jaded, for heaven's sake. Second, and perhaps more important, human beings that we all are, we develop certain working relationships. If we are in an agency too long working with the senior career staff and sometimes long-term political holdovers, inevitably there may be some unconscious attempt to concede on matters where we should not make concessions. Conversely, we may try to be tough where we need not be tough or, depending on the situation, of being "phony tough." There is a danger of such "corruption" and, to get around that and to get around the possibility of politicization during the quadrennial election, I believe there should be a set term of office.

I must also raise to your attention another problem which has received no publicity, but which gives me considerable concern, and that is the unique vulnerabilities which arise when an IG vacancy exists for a long time. This is happening right now. The VA IG vacancy is approaching 2 years. USDA has picked somebody, but it took a long time. There are a number of other agencies. Justice and Treasury are both in the new Act. Treasury, I understand, has somebody; but Justice apparently is not even close to that, nor does FEMA have anybody. Yet in the law that was passed last November, the amendments to the IG Act, those offices were to be fully

operational in April. So, we are going along for a long time without an IG incumbent in a number of Cabinet Departments.

The difficulty here is that if you are sitting as an Acting IG or a Deputy IG, I do not care how tough you are, I do not care how able you are, I do not care how aggressive you are, the fact of the matter is that you are under the gun, especially if you are looking for the job yourself. Inevitably, somebody may think, the perception may be there, even if it is not true, that you are trimming your sails. After all, you do not have the power of a political office behind you. You do not have a presidential appointee fighting for this agency, you are out there naked on your own. That is why it is so terribly important that we speed up this interregnum between the departure of an IG and the appointment of a future IG. It is something that I hope the PCIE can do something about.

Another issue I would strongly urge be addressed is the authority of IGs to have their own separate office of counsel. About five of us have our own offices of counsel. I have had one since I came in. I had to fight for it when I arrived at Commerce, because there was an attempt to take it away from me. I had to go down to Secretary Mac Baldrige and make it a test of my manhood, and say, "Look, I can't live without this." It worked, but a lot of other IG's, most of them, do not have their own counsel. Some are experiencing great difficulty trying to get this, and the basic reason is that many general counsels do not want to have a lot of lawyers floating around a building not under their control. So, I would strongly urge that the next time a package of amendments is put together, that the counsel for the IG be specifically included in that package.

Before I talk about the difficulties we have been having with the Justice Department, let me also urge that any future body of amendments seriously consider and support the recognition that the law enforcement authorities of the Inspectors General should be fully backed with the necessary requisites for our investigators to carry firearms, if need be, and to make arrests. Those two are the essentials, and also to conduct searches, of course.

We do this now. My people are deputized, if they have to be. We have a number of standing deputizations. My people operate in very sensitive undercover situations at times. When you are dealing in the areas we do, we need these tools.

I shudder to think that it may require somebody being blown away before action is taken on this. Our investigative force in the Inspector General community is carefully screened and trained; if they are already authorized to carry weapons in certain situations, they are required to be requalified repeatedly. Most of them in my shop, come from other law enforcement agencies. They already have the necessary background and training. I strongly urge that their needs be addressed.

Finally, a few words about the Office of Legal Counsel (the OLC) opinion, which has caused so much controversy and talk. I say in my prepared statement that this has been blown out of proportion, and I believe it has been. But I want to emphasize that there has indeed been a deep difference of opinion between most of the IG's and the Department of Justice about the OLC opinion. However, none of us wants to pick a fight with Justice, and I do not believe

that the vast majority of the Justice Department wants to pick a fight with us.

After all, we cannot operate, I repeat, we cannot operate an investigative program without the ability to call on the Department of Justice or to refer cases to the prosecuting attorneys or to litigating divisions of Main Justice. On the other hand, we make thousands of cases for the U.S. Attorneys. We are a wonderful source of fraud cases for them to prosecute. So, nobody wants to have a fight and we find ourselves in a situation which, frankly, has not been too pleasant.

We are trying now—I do not think it is appropriate to go into detail on what is under way—we are trying now to arrive at a compromise solution that, no matter how phrased, will give us the latitude to conduct the kind of reviews needed to give us the assurance that we are not omitting or not referring, as we should, examples of fraud, waste and abuse in regulatory agencies as well as in our own programs and operations of the departments in which we are the IG.

This process is under way right now. I have not come to closure on it. Will it solve all of the problems? Almost certainly not, but it will solve most of them and it will give the assurance that I mentioned, that we are not going to be turned away from areas that require our review.

I have not even had a chance as yet—this happened in the last few days—I have not had a chance to have my colleagues vet the proposed agreement. When we do, we will go back to Justice and I hope we will have a workable situation. None of us wants this fight, neither Justice nor we.

That concludes my statement, sir.

Chairman GLENN [presiding]. Thank you very much, Mr. Funk.

Let me follow up on your last comments, that this has been blown widely out of proportion. We have given the IG's broad powers, for good reason. It involves not only government dollars which we concentrate on here a lot of times, but it is also the implementation of policy and the ability of the departments to perform their functions and perform them well and have the IG really looking over that to see that they are doing that. It is not all dollars and audits and balance sheets.

The Justice Department's Kmiec decision has been interpreted basically as restricting the IG's jurisdiction to government dollars and government employees. Now, that decision has been used to do such things as interfere with the following: The Department of Transportation IG looking into the policy on airline pilots who use drugs whether it was being implemented and carried out properly and the Health and Human Services investigations of whether the Department was pursuing properly unlawful activity in the generic drug licensing process.

I believe you made statements to your own staff about some restrictions imposed upon visa fraud investigations. Now, I have seen those areas I just mentioned as completely legitimate for the IG's to get into. That is the reason that I was sorry to see the Attorney General's decision come out.

Do you feel that we should not be getting into any areas except where there is an expenditure of government dollars or where it

directly involves government employees? That is the basic part of the A.G. decision, as I understand it.

Mr. FUNK. I emphatically feel that we should and, indeed, we are. For example, sir, if I am walking down the street and somebody stops me and says, "Mr. Funk, there is somebody manufacturing a passport in the basement of this house," that is none of my concern. I can call the Secret Service and I can call the Bureau of Diplomatic Security from State, and I can even call in a local cop, though he would probably not have jurisdiction either. But I have no jurisdiction over that. That is a private party doing something, without regard to the government, playing with a piece of paper, making a passport.

The moment that individual walks into one of our embassies or consulates with that phony piece of paper and wants to get some kind of authentication, to me that is a Federal benefit, a passport or a visa is a Federal benefit, and I believe that a Federal benefit comes under our aegis.

Let me also say, sir, that the Program Fraud Civil Remedies Act, about which I testified before you and Senator Roth several times, is a wonderful piece of legislation. That Act explicitly, says that it is within our province to look at false claims and false statements as they relate to Federal benefits. What is a Federal benefit? It need not be in dollars. A passport is an enormous benefit. In the cases of a drug manufacturer who applies for a license, no dollars are coming out of Uncle Sam as such, but that benefit in the form of that license could make many millions of dollars for somebody.

Chairman GLENN. Let me use your own example there to make the point of how I view this. I agree with you, if you are going down the street and somebody says there are drugs going on in there, you as IG have no jurisdiction. But here is the main point:

If you were the IG at an agency that had jurisdiction over the drug traffic and your agency then was charged with following up with proper policies to deal with this, and you were looking into whether they were following up in establishing those policies pursuant to a law that Congress had passed, now you would be prohibited, as I understand it, from even looking into whether your agency was executing those policies——

Mr. FUNK. No, sir.

Chairman GLENN [continuing]. Not with going in and arresting the guy, but with establishing the policies. Now, that is the way it has been interpreted.

Mr. FUNK. No, sir, the Kmiec opinion admits that the IG's have explicit oversight authority, that has never been in question. They could not question that, it is simply too obvious. The fact is that we do have total oversight authority. We can go into any operation, if it is in our Department or under our authority, and we can examine how well are you operating that. Even if a third party, an external party is involved who is not getting funds, we still have a right to go in and review how an investigation is being conducted by somebody else. Or we could review how well the Department is conducting an investigation. That is an oversight role; we do that all the time, and the Kmiec opinion explicitly says it does not talk about that part of it. So, the issue that you just mentioned, sir, is not covered by the Kmiec opinion.

Chairman GLENN. Okay. We are going to have to look at this, because I know most of the other IG's that we have talked to, so far at least, have a differing opinion from yours on this. They feel that it does have a chilling effect on their ability to do their job.

Mr. FUNK. If it is let stand, no doubt about it. I think we will be able to come to a compromise, but if it stands as it is, yes, sir.

Chairman GLENN. We will be addressing some of that on Tuesday and I am sure we will want to talk to Mr. Darman about his views on that next Thursday when he comes to testify before us, too.

Seven years is what you still favor, the statutory length of tenure?

Mr. FUNK. Yes, sir. I am not going to throw myself on the sword for 7 years or 9 years, but I believe it should be at least 7, yes, sir.

Chairman GLENN. And have you been told why the appointments to these IG positions have been delayed so long? We have had a lot of appointments delayed in not just IG, but other areas also, but it seems to me the IG's are ones that really are important to get at and get in place.

Mr. FUNK. For the reasons I said earlier—I do not know if you were back yet, sir—the office of the Inspector General is particularly vulnerable if it does not have a head. That is why I think we have to move quickly in this area. Again, I have to say that the appointments have been slow all over town. We have not been picked out uniquely for slow appointments.

Chairman GLENN. As Vice Chairman of the PCIE, do you believe that a statutory IG, if one is created at the CIA, should be prevented from reporting criminal activity directly to either the A.G. or the Intelligence Committee, rather than having to report only to the Director?

Mr. FUNK. Yes, I testified on this before the Senate Select Committee on Intelligence a year ago. I will be very honest with you: Any statutory IG at the Agency would have to be picked with some care, because if you pick anybody outside the intelligence community, the chances are very likely he or she will not know what questions to ask. In that business, if you do not know the right questions, you are not going to get any answers. So that is why I think, number one, if there is a statutory IG for the Central Intelligence Agency, the person should be limited to somebody from the intelligence community.

I must also say, with no disrespect to this Committee or any other committee, I must tell you that I would have severe problems in widespread distribution of intelligence information across the board. In my own case, I would say to you and other oversight chairmen, that my security oversight reports are being kept in my office, and anybody from the Hill who is cleared is welcome to come and read them. No notes or copies, but they can look at them. While we are not dealing with this kind of information from the CIA, I think a statutory IG has 535 people looking down his throat all the time. That would give me some concern, if I were over there at Langley.

Chairman GLENN. We are looking at that now in the other committee. I am a member of the Intelligence Committee, and Senator Roth was a member of that committee a short time. We are seeing

if we think it can be done with adequate protections. I certainly am the last person on Capitol Hill that is ever going to want to set up a mechanism that is going to breach any of our security secrets. At the same time, I think maybe some of the recent past difficulties might have been avoided had there been some people out there looking into these things. I do not know that that is the case, but I feel that we can write those kinds of protections in and do an adequate job of it and still make sure that there is adequate monitoring going on.

Mr. FUNK. Yes, sir.

Chairman GLENN. Can you take over? I have got another meeting and I have got to go, Bill. Thank you.

Thank you, Mr. Funk.

Mr. FUNK. Thank you, Mr. Chairman.

Senator ROTH [presiding]. One of my major concerns has been the frequent lack of personal accountability within the Federal Government when problems occur, and often as a result I think the same problems keep reoccurring. In that regard, I would like to quote from the first page of your latest semiannual report and the cover memorandum to the Secretary:

In my first meeting with you, I said that one of my most important goals is to reinforce the concept of accountability in the Department by holding managers personally accountable where this is possible, that is, when we can draw a nexus between a lapse in management and their own actions or inaction.

Too often, we find that blame is not assigned at all for mismanagement. When it is, the blame too often stops with the junior officer immediately responsible for a problem, rather than with the supervisors who knowingly permitted or even may have caused, the problem to arise or continue.

I think that is a very perceptive statement, Mr. Funk.

Mr. FUNK. Thank you, Senator.

Senator ROTH. But how common do you think that problem is throughout the government, both with management as well as with the IG's? Why is there a reluctance to fix accountability and to take action regarding those responsible?

Mr. FUNK. Because it is very easy to speak in glowing rhetorical terms about people doing something better, but when you know that you are going to take an action which is going to immediately or potentially hurt somebody's career, let alone going beyond that, to possible criminal action, serving time, most people are very reluctant to take that on. When you are dealing with senior people, even more so.

I found that action against ambassadors was almost considered heresy, it just is not done. Several senior officials told me that they did not know how even to approach that. What do you do? This is a presidential appointee, a personal representative of the President, how do you discipline him or her? But in point of fact, we have established a precedent. For example, let's say that an ambassador sends a cable to me or to an Under Secretary or to the Secretary saying that a physical inventory was done and it was in good shape, we found no anomalies. Let's say also that one of my teams goes there later and finds that the statement in that cable was fictitious and that the ambassador knew when he signed the cable that it was fictitious. We hold that ambassador responsible, I don't want to put the arm just on the general services officer, the young

kid maybe, maybe a young first tour officer, who did not know any better, who gave the ambassador false information. If we think the ambassador knew or should have known, that is the criteria we use. If he or she knew or should have known that this thing was false, then he or she bloody well should not have signed it. Because if he did, it was deliberate misrepresentation. We have had several cases where disciplinary action has been taken in exactly such cases. These are not just hypothetical examples. We have done this elsewhere as well.

It is not fair to pick on the young officer, often untrained, often anxious to please. Nobody wants to upset the ambassador, nobody wants to upset an Assistant Secretary. Why pick only on that junior person? I think we should pick on both and we do. I do not want anybody giving me the Adolph Eichman argument, you know, "I was ordered to." We try and give people the stamina to just say no, if they get a bad order.

Senator ROTH. Mr. Funk, I have been impressed this morning that—unfortunately, I missed one, but the other three have all indicated good cooperation from the agency itself in the administration of your work.

One of the things, however, that concerns me, looking at the HUD case, is that if you look at their various semiannual reports, time and again they will say that there are certain problems—I am looking at Report No. 7, 10-81, "but we would like to comment on the unprecedented cooperation we have received from the current management team." 4-82, "HUD managers and employees are cooperating in supporting our work. There has been increased emphasis by managers on accountability of HUD staff and program participations." 10-82, "We are working with program managers to resolve and correct these problems"—and I could read report after report, and it bothers me.

Mr. FUNK. That is right.

Senator ROTH. First of all, it is the IG who is supposed to call attention to management itself, that there are problems, so that hopefully management itself will take the steps that are necessary to correct it. If management does not do it, then under the law, under the legislation creating it, it is the responsibility of the IG to report it to the Congress, not in that order, but to report to the Congress.

Frankly, just reading through these, you know, you sort of think there really is not a problem, that it is being taken care of. Subsequent events show that that is not the case. Now, I do not want to prejudge, because there have been hearings in the Banking Committee, and I think that is important, but the thing that bothers me, does this indicate too cozy a relationship or what?

If I read these when they came out, I would think, well, everything is pretty good, I do not have to worry about it. Let's face the fact that Members of the Congress are not going to read, let alone understand, these reports to be candid.

Mr. FUNK. That is barred by the Constitution, it is cruel and unusual punishment.

Senator ROTH. But what bothers me is we are trying to set up a system that will alert management and Congress to any significant problems. We have this one case where it has obviously failed. It

did not fail when you had a new Secretary who was concerned. He moved and moved fast. But what I am saying is what do we do about this?

Mr. FUNK. Several things. First, sir, it is our job not only to identify a difficulty, that is only part of it. The next thing we have to do is to bring it to somebody's attention, and that means we have to lay it out very clearly and very explicitly.

Now, most people do not understand, for example, auditors' language. If an auditor says that internal controls are weak, that is very meaningful to an auditor. He knows exactly what that means. But if a manager picks up a report and it says "internal controls are weak," his eyes glaze over. He could care less about that. It does not seem compelling to him, that is, compelling enough to require urgent action. And that may be part of the difficulty. It is important that we learn to phrase—I do not mean to be dramatic or try to make every report like the *National Enquirer*, of course not, but, nevertheless—we should be able to phrase our reports in such a way that the impact is spelled out. Not just that we found something wrong, but what is going to result because of this vulnerability, because of this weakness. If we do a better job of doing that, I think that part of the problem will be solved.

The other issue you mentioned is much more deeply rooted. When you helped to create the IG Act 12 years ago, Senator Roth, you really gave birth to something perhaps better than you even knew, but it does have a couple of built-in difficulties. One of them I described many, many years ago when I hosted the first PCIE workshop. I called it "straddling the barbed-wire fence." Anybody in the Executive Branch is going to be suspicious as heck if anybody in his employ reports directly to the Hill and there are honest concerns about that.

Now, let's multiply these concerns. Suppose an IG gives bad news to the Hill, and someone up here slips it to a newspaper. The next thing, the bad news is blazed on page 1. It is no wonder that we often are regarded with great suspicion.

The Hill is worried about the IG's being co-opted by management, and management is worried about our being a conduit to the Hill. We are stuck right in the middle. If we are seen talking to somebody from the Hill, "Ah-huh, the IG's leaking information or giving away stuff about his findings." If we get too cozy with management, we are being co-opted. This is what I call straddling the barbed wire fence.

It is not an easy thing to solve, it really is not, but unfortunately it does not go away simply by talking about it. It must be faced up to. If you have a manager who is not worried about his or her competence, who is not afraid to face up to difficult choices, then there is no problem. The problem is only if you have a manager who is uneasy, who is the kind of person who is reluctant to face up to difficult situations. Then you do have a problem, and, as I say, you cannot legislate that kind of ability on the management side nor can you do it on the IG side. We have to rely upon good screening, good selection and, hopefully, we'll get people with the right intestinal fortitude.

It is not an easy job. I say again that the guts of the job is first we have got to find the problem and then, by God, we have got to

spell it out in simple explicit terms so that people will know that there is a problem.

Senator ROTH. As far as I am concerned, the main thrust of this legislation, the IG legislation, is to help insure that there is a system that will, in turn, insure that the taxpayer dollar is being well-spent. That is the whole purpose, and there are going to be exceptions and there are going to be problems. I mean, I do not care how good the system is, there are always a few who will take advantage. I think part of the problem is that too often, because the Congress and the executive are co-equal and separate, that there is this tendency to want to make headlines, which does not necessarily help the system, and that creates the kind of problem you are talking about.

I would like to ask you, because you have a wealth of experience, how do we get some kind of a synopsis, a grading or whatever, periodically, because there is no way that the members of the Senate are going to read the reports. They really do not have the time, to be fair about it.

Mr. FUNK. Let me tell you what I am doing, sir. I told Secretary Baker, at a staff meeting not long ago, that—precisely to avoid any feeling that I may not really be calling the shots as we see them or that I may be trying to bury our problems—although fortunately, they are not as vast as other agencies'—my next semiannual report is going to have a box right up front on the first page listing what I regard as the outstanding problems of the Department.

Now, the difficulty is that I do not have total information on all of these problems. I have not done solid audit work on all of them, so somebody can come back and say to me, you are shooting from the hip or you are using intuition, instead of knowledge. To quote George Bernard Shaw, "It is a little of both, governor, it is a little of both," because in fact I do not have full data on all of these. But if I have reason to believe this is, in fact, a major problem, I should say so. We are going to do that and I hope other IG's will also do something like that. So when you see my next semiannual report, there will be a box up front with a list of what I regard as the outstanding problems in the Department of State.

Senator ROTH. The hour is getting late, but let me ask one further question with respect to the use of 7-day letters, which presumably was to be the principal tool in getting the attention of the agency and Congress. What is the attitude generally towards the 7-day letter? Are they being utilized, are they effective?

Mr. FUNK. I did a study for the PCIE on that about 4 years ago, when I was still with Commerce. Basically, the IG's look at the 7-day letter not in the language of the law. The law simply says you can report serious problems, period. Most of the IG's regard it the way June Brown mentioned it this morning. That is, if I have a difficulty, if I find a very serious problem in the department, I refer it to management. If management is not doing anything about it, then there should be grounds for a 7-day letter.

Our survey found a couple of interesting things. First, what if you had a war and nobody came? In a number of cases, 7-day letters have been written by IG's and they disappeared into a void here on Capitol Hill, sir, and that does not give us much confidence. When you say, well, if I get into a bad scene, I am going to

slip them a 7-day letter and then you do it and you have no hole card left, at that point you are very naked, sir, you are very naked indeed. So, you have to be careful, if you pull a gun, there damn well better be ammunition in it, and that is one problem.

In my earlier testimony last year before Chairman Brooks, Jack Brooks, I suggested that there be language requiring some kind of reply from the Congress to 7-day letters, not saying what it should be, nor giving format or any of that detail. But there should be some kind of reply, because an IG is very vulnerable if he shoots his wad before the Secretary of his department and then nothing happens.

Senator ROTH. Well, I think part of the problem is unquestionably up here on the Hill. Frankly, one of the reasons I am fighting with Wendell Ford and others to get a 2-year budget is that I do not think Congress is discharging its oversight, and partly because we are constantly caught up in this budgetary problem full time. If we had a 2-year budget, at least one year we could give some time to oversight.

I also do not think this Committee can do all of it. I mean we are talking of four different departments this morning, which I think is excellent, but it is no substitute for the authorization committee, who has responsibility for the programs, to look in greater detail. This is a matter of real concern, because, you know, going to the HUD case, the system failed.

Mr. FUNK. It did, indeed.

Senator ROTH. It did not fail when Kemp got involved, but somehow it failed before that, for whatever reason. In other words, what we have done is not resolve an early alert for the correction and prevention of waste. I am not talking about a little waste, we all know there is going to be a certain amount.

Mr. FUNK. Sure.

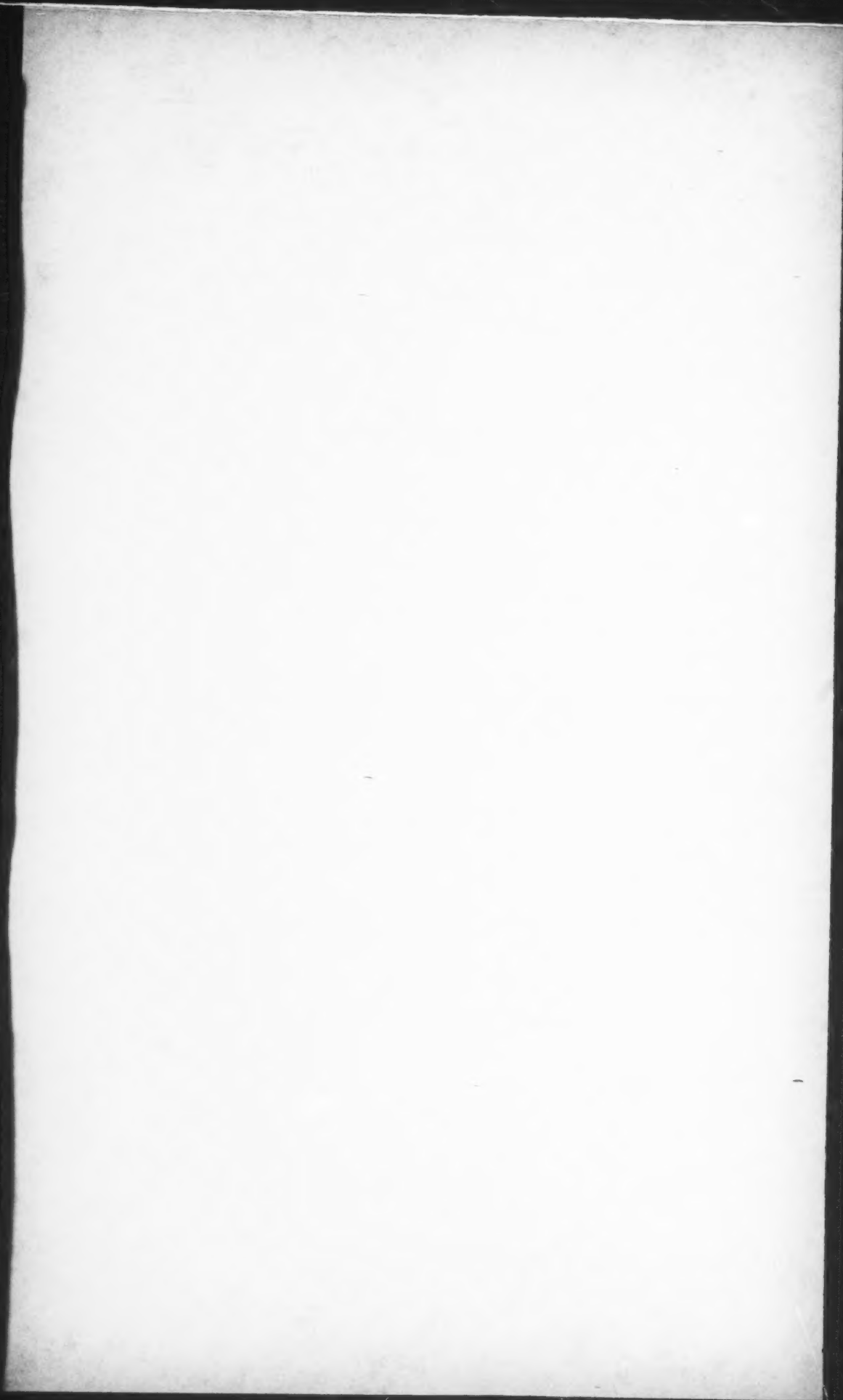
Senator ROTH. But here we are talking about huge amounts that lose confidence in government.

I thank you very much, Mr. Funk, and I apologize for the lateness of the hour.

Mr. FUNK. Thank you very much, Senator.

Senator ROTH. The Committee now stands adjourned.

[Whereupon, at 12:55 p.m., the Committee was adjourned.]



SERIOUS MANAGEMENT PROBLEMS IN THE U.S. GOVERNMENT

TUESDAY, OCTOBER 3, 1989

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Committee met, pursuant to notice, at 9:35 a.m., in room SD-342, Dirksen Senate Office Building, Hon. John Glenn, Chairman of the Committee, presiding.

Present: Senators Glenn, Nunn, Levin, and Cohen.

OPENING STATEMENT OF CHAIRMAN GLENN

Chairman GLENN. The hearing will be in order.

This is the second in our series of hearings to consider serious management problems in the Federal Government. It is within the purview of this Committee, it is our responsibility, as a matter of fact, to oversee the efficiencies of Government. When you get into efficiencies of Government, I wish we had a staff of a thousand and all sorts of inspectors, because we have enough areas to look into.

But our focus today is on three domestic agencies, the Department of Health and Human Services, the Department of Labor, and the Environmental Protection Agency. Our messengers today, if you want to look at them that way, will be the Inspectors General for each of these agencies who, in each case, is, in my view, the one Government official we in Congress must be able to count on to report that bad news as a messenger, and without mincing words.

Of course, in order for the Inspector General to be in such a position he must have the authority and the tools to do the job. Today we will explore in detail a controversy that has swept through the Inspector General community as a result of a recent Justice Department legal opinion. This opinion cites certain legislative history surrounding the 1978 Inspector General Act in support of its conclusion that the IG's investigative authority is limited to cases where Federal employees or Federal funds are employed.

Moreover, it rejects as unlawful any attempt by an agency head to delegate additional investigative authority to the IG. As a result, the Inspectors General at HHS, Labor, and EPA have either stopped doing certain investigations involving the integrity of programs in their agencies, or have continued to work under a legal cloud.

Today's hearing provides a good opportunity to consider what we in Congress want from the IG's in this area and to consider whether a statutory clarification is necessary. Just this week's Business

Week, for instance, has a two page article here on "A Shorter Leash For the Inspectors General."

The Justice Department wants to clap limits on their jurisdiction. That was never intended in the legislation, and how we work our way out of this isn't quite clear at the moment, but it is a major news article here that pretty well describes exactly what the situation is.

The remainder of the hearing will highlight significant management deficiencies in these three domestic agencies. They have a combined budget authority of nearly \$514 billion of which approximately \$74 billion—nearly 15 percent—is expended on just grants and contracts. Unfortunately, today's bad news reinforces a theme from last week's hearing with the IGs at our key national security agencies, that the contract and grant oversight functions throughout Government need major improvement.

On Thursday of this week we will hear from the Director of the Office of Management and Budget, Mr. Darman, on OMB's response to these and other management problems that have come to light through our hearings.

Those of you that have followed our deliberations or our hearing activities over the last couple of years know that we have made a major effort to put the "M" back in OMB. When that law was changed taking the old Budget Office and making it into the Office of Management and Budget, we expected that there would be a lot of follow-up and we want to make certain that, in particular with regard to what the IGs are doing in uncovering some of these difficulties within departments and agencies, and that OMB is then, in fact, moving aggressively to take care of these concerns.

Senator Heinz is unable to attend today's hearing and has a statement that he would like placed in the record.

[Senator Heinz' prepared statement follows:]

OPENING STATEMENT OF SENATOR HEINZ

Mr. Chairman, I want to thank you for holding this hearing on implementation of the Inspector General Act. As we continue examining the operations performed by Inspector Generals, I look forward to the IGs own analysis of how successful these offices have been and where they may need improving. IGs are our "frontline soldiers" in the campaign to detect and expose waste, fraud, and abuse in the day-to-day operation of our Federal government.

Recommendations made during the previous hearing will be very useful to this committee as it continues its oversight of the Offices of Inspector General. A set term of office for IGs overlapping the quadrennial election, arrest authority, and the challenges of establishing an IG at the Central Intelligence Agency are a few of the ideas that prompt future consideration.

This Committee may need to begin examining the programs within the various departments under the supervision of IGs rather than the IGs themselves. Following the testimony of the IG at the Department of Energy, a more in-depth examination of DOE's "management and operation" contracts, for example, might improve the efficiency of that Department's internal mission. The IGs have proven successful in carrying out their mission. In FY 1983 the IG at the Environmental Protection Agency reported investigative recoveries totalling \$1.7 million, recoveries and restitutions arising from IG findings of \$53 million, and savings and avoidance of unnecessary expenditures of \$47.7 million.

The continued success of IGs in ferreting out fraud and improving government efficiency, however, is predicated upon the independence of these offices. In some instances it may appear this independence has been infringed upon and needs shored up. It is important that the underlying purpose of the IGs is not weakened by administrative decisions.

Thank you, again, Mr. Chairman and I am looking forward to hearing from today's witnesses.

Chairman GLENN. Today we have Mr. Richard Kusserow, Inspector General of Health and Human Services; we have Raymond Maria, Acting Inspector General, Department of Labor; and John Martin, Inspector General, EPA, Environmental Protection Agency.

Mr. Kusserow, we welcome your statement this morning and if you would lead off, we would appreciate it.

**TESTIMONY OF RICHARD P. KUSSEROW, INSPECTOR GENERAL,
DEPARTMENT OF HEALTH AND HUMAN SERVICES**

Mr. KUSSEROW. Thank you, Mr. Chairman.

In your letter requesting our testimony you suggested that I use as a point of departure the Federal Manager's Financial Integrity Act, which was a piece of legislation that Congress passed in 1982 to reduce the vulnerabilities in the program agencies to fraud, waste and abuse through a process of internal control reviews and studies.

With your permission, Mr. Chairman, I would like to submit for the record, my entire testimony which lays forth the background and how the Act is being implemented, and focus more upon how it is actually working in our department.¹

Chairman GLENN. Your entire statement will be included in the record.

Mr. KUSSEROW. I would just underscore a couple of points you made in your opening remarks.

First of all, it looks like in this next year's budget, our Department, itself, will exceed a half trillion dollars in outlays. So, it is quite important that we make sure that the Department's programs operate in a cost-effective and efficient manner.

I also would just underscore, lest I forget later on, that legislation is required to clarify the status of the investigative authority of the Inspectors General, as well as audit authority.

As we began to implement the Federal Manager's Financial Integrity Act, what we found is a general reluctance on the part of program managers to admit that there is anything wrong in the department or agency. Somehow, the whole thrust of that legislation has been lost. It really was originally designed that it would not be a sin to identify a material weakness; instead it would be a sin not to identify one. And indeed, if you did identify a material weakness within a program or an agency, the important thing was to have a corrective action plan and to correct it. It was designed so that people who were involved in oversight, such as GAO and the Inspectors General, would not be the ones carrying the ball on this, it was expected that program managers would do it.

I brought a couple of charts, Mr. Chairman, that really just give you a visual impression of what is going on in HHS with regard to this program. As you can see, if you look at the program side, the blue, the program managers are reporting very, very few material weaknesses. The preponderant reporting of material weaknesses

¹ See p. 208.

within the Department comes from the green bar, which is Inspector General, and the yellow bar, which is GAO. Therefore, what you can see easily is that it is auditors that are carrying it. It was never thought that the auditors would be, in fact, the ones carrying the load on this.

I am pleased to report that Secretary Sullivan has seen the fact that this process needs to be fortified. As a result of his direction, the Assistant Secretary for Management and Budget has set up a Management Oversight Council that is now holding hearings within the Department to explore why the agencies within our Department are having such difficulty with this process and are unable to come up with material weaknesses.

This should not be a paper exercise. Indeed, as we look at where scandals appear in our Department, we oftentimes will note there is a correlation in the failure to do internal control reviews and a failure of management to correct its own problems. So, I don't want to convey that even with the innovations and changes in direction in this Administration that we have really cured this problem. Thus far this year and last year, we have had approximately a thousand internal control reviews performed by management. You will see there in 1989, Mr. Chairman, one material weakness was reported, and it wasn't reported by the program people, it was by the Assistant Secretary for Management and Budget, himself.

So we have an agency that is going to have half a trillion dollars in outlays, and yet they have no material weaknesses that they are reporting on their own. For example, in the last 3 years the Social Security Administration, a program employing some 68,000 individuals, handling over a quarter of the trillion dollars in benefits for approximately 40 million beneficiaries, has not been able to identify a single material weakness. At the same time, we in the OIG have had no difficulty in identifying them.

Similarly, 12 percent of the outlays for the Federal Government is in the Health Care Financing Administration, and they too, over the last 3 years, have been unable to identify more than one material weakness, while we have had no difficulty in identifying quite a few. Now, these material weaknesses that we identify are not planned; they are just incidental to the work that we normally do.

I would like now to jump to a couple of examples of why it is important that we do have a good process here. If you look at the point-of-sale system for the new catastrophic Medicare drug benefit, we have a program that is going to be very, very costly to implement. We have issued two reports in this area that cause us concern. As we looked at the Congressional intent in the catastrophic health insurance benefits, we saw, with regard to the drug component, that Congress really had intended that there would be a process by which we could identify those drugs that interact badly, causing potential hospitalizations for our beneficiaries, and to give the beneficiaries that kind of feedback at the point of sale.

We also looked at the implementation schedule. Congress had set an implementation schedule for the catastrophic drug benefit to be January, 1991. On that date you were supposed to flip a switch and nationwide you were going to have beneficiaries plugged into the system and instantly have the drugs used posted to their account.

The difficulty is that is supposed to be a nationwide effort. So if you have a snowbird going from Maine or Ohio down to Florida and going to different pharmacies along the way, supposedly it is all going to be instantaneously posted. Or, if somebody gets in the Winnebago and goes from the East Coast to the West Coast, stopping along the way at pharmacists to have their prescriptions filled, somehow it is supposed to be posted instantaneously.

HCFA is going to proceed with three major contracts for the point-of-sale system. Those three contractors will be allowed to have their own hardware and software, so long as they have the data elements that the Health Care Financing Administration requires. Then, it is going through a prime data contractor, which will be one of the three point-of-sale contractors. They will use some sort of a black box. All of the data will go and be integrated and somehow get instantaneously posted.

All of this is required to be done by January 1991. Quite frankly, anybody in our Department that thinks that could happen should be advised that the tooth fairy is not really an individual who leaves money for teeth. I just cannot see how that project can be completed timely. Mr. Chairman, if that benefit stays in place and if they do get it going in January 1991, I would like to have you invite me back so I can submit my resignation to you. I feel that strongly that it will not happen.

The problem, as we reviewed this process, is that this is the largest systems contract ever purchased by HCFA. They have little experience with large systems development and implementation. If they believe they can go out with an RFP and have a contract be awarded within 6 months, it just belies the reality of Government contracting.

We looked back in our Department and found that the average length of time with regard to contracting phase for new systems coming on line, is a minimum of 12 months. The vast majority of the contracts that we looked at were far simpler than this enormously complicated one being implemented by HCFA. Just to double check it, though, we went to GSA and looked across the entire Federal Government. The same thing is true. The average length of time just for awarding the contract is 12 months.

HCFA planned to award that contract in 6 months, presumably January 1990. Then the contractor has 12 months in which to design, build and implement this system. The contractor would have to take all the bugs out of it so that on January 1, 1991, you press a button and these three contractors will somehow be able to come online, be able to post all the drug benefits, go through this black box and be integrated so that no matter where a beneficiary goes in the country their drug usage gets posted. I just don't believe that is possible. We made recommendations as to how HCFA management can improve their process, but they are not changing the process.

It is not that HC are not trying. It is just that Congress gave them an unrealistic date, and quite frankly, HCFA should have gone back to the Congress and told them that they need more time. They are stripping gears and dropping transmissions to make that artificial date, and as a result they are cutting corners which increases risks for our process.

When you think that for 1990 we have \$100 million being devoted to the system startup, that grows to \$500 million in 1991, \$700 million in 1992, \$800 million in 1993, and that it is going to process program benefits of about \$1.6 billion—which is probably an understatement at this point—this is a very important and very significant. If we do not believe we can do it, we should come forth and admit it. At least I am coming forth and saying that it won't work, and if it does work, then I will happily move on to greener pastures and find some other place to get my employment check.

We also have looked at, as you know, the generic drug approval process at the FDA. We entered into that situation as a result of a criminal investigation. As a result of that initial criminal investigation, we have to date convicted through the U.S. District Court three individuals who were taking bribes at FDA, three individual representatives of drug companies for paying bribes, and two companies for the conspiracy to do the same.

As we looked at the approval process at FDA we found they had never identified a material weakness. Indeed, they had performed an internal control review of only one of their six approval processes. Further, they hadn't even adequately taken the first step, which was mandated in 1982, to go through a segmentation process to identify those areas that were subject to review.

I am not saying that the entire problem that we uncovered could have been prevented if indeed they had gone through the internal control review process. But I will say that, the risk would have been reduced enormously if they had, reviewed that process. They are now doing that, and they are doing it with all of the approval processes at FDA and throughout the whole program. I think they have learned the hard way that it is really necessary.

I would like to skip to, if I could, Mr. Chairman, an area that has had a great deal of Congressional scrutiny thus far—Indian Health Service, where we found a lot of problems and a lot of investigations on the programmatic side of that program, which is \$1.1 billion. They had never performed an internal control review of their health care delivery systems. Therefore they could not find a material weakness, and yet we have a number of criminal investigations arising out of it.

The next one I would like to mention—

Chairman GLENN. What was that one? That was Indian Health Service?

Mr. KUSSEROW. Indian Health Service, yes, sir.

The next one I would refer to is the Secondary Payer program in Medicare. Congress said that Medicare would be the secondary payer, not the primary payer, to private health insurers when a beneficiary had employer group health or automobile accident coverage. If you get into an automobile accident, it should be the private insurance company that pays first, and Medicare second. The same thing holds true for employer group insurance policies.

One of the things that we have found that disturbs us greatly is that \$400 million to \$900 million is being denied Medicare annually by health insurance companies who are failing to report and pay as they are obligated to under Federal law.

Incidentally, Mr. Chairman, we are conducting a number of investigations. The Department of Justice, Civil Division, has re-

quested us to look at a number of investigations arising from qui tam suits brought against certain health insurers. We have a criminal investigation against one health insurer, and we have a number of different audits in support of Department of Justice.

But going back to your opening remarks, if I could just tie in the relevance of why things are confusing. Let's ask the question, do I have jurisdiction to look at that? Medicare is paying \$400 million to \$900 million a year that they should not pay and yet are the insurers employees of the Department? No. Are they receiving program dollars from the Department? No. These insurers aren't paying us the money that they should be paying us.

Therefore, I, under the Department of Justice's Office of Legal Counsel strict interpretation, would have no jurisdiction to either audit or investigate in this arena because it does not involve program dollars. This is exactly the kind of thing you have seen in previous testimony where you have people involved in oil and gas leases, for example, where they are supposed to be paying to rather than receiving from the Government. This situation occurs in other areas that can be replicated across the whole Federal Government.

But here we have a huge problem that is affecting the vitality of the Medicare trust funds and there is some question as to whether I can even investigate it. And yet I am doing it at the request of the Civil Division of the Department of Justice on one set of investigations, and the criminal investigation and the U.S. Attorney's Office in the second set of investigations. So there is a certain unreality about that.

The last area, which I will just pass over rather than mention, is the area of small purchase procurements at NIH. Once again, there has been a failure by program managers to identify a material weakness. As a result, millions of dollars have been lost that could be better placed in biomedical research rather than in paying exorbitant prices for small procurements.

With that, Mr. Chairman, I would like to reserve whatever time I have left for questions. I will mention that I did give you a list of recommendations and that you and the Committee might want to look at how we might remedy problems with the FMFIA. It includes also things that I believe that we should be doing to make the process meet the original intent of Congress.

Thank you.

Chairman GLENN. Thank you very much, Mr. Kusserow.

Your testimony concerning the Health Care Financing Administration's design and procurement of this point of sale electronic system for prescription drug claims—now, this will be a \$500 million system, just \$500 million to operate it, supposedly, in 1991, if it comes on stream; is that correct?

Mr. KUSSEROW. That's correct.

Chairman GLENN. And how much would it cost to put the system in place?

Mr. KUSSEROW. Well, for 1990 we will have \$100 million, then \$500 million in 1991, \$700 million in 1992, and then going to \$800 million in 1993. It will then process about \$700 million claims a year and will pay out or keep track of program benefits to the extent of about \$1.6 billion.

Chairman GLENN. As I understand it, the systems that are being procured are not matching systems; is that correct?

Mr. KUSSEROW. This is the approach that HCFA is taking. They believe that they are going to have three different contracts and that in each of, three geographic locations, they are going to allow for the contractor to have their own hardware and software approach to it. The reasoning behind this approach is that if one fails, then maybe the other two will be all right. They have built into the contract an ability to absorb the failure of a third contract if it couldn't come on line.

So they say they are going to ask for greater capability, and follow the old adage that if you have three different contracts and three different approaches, then if one fails you haven't put all your eggs in one basket. That is their reasoning.

Chairman GLENN. But will these different systems be able to talk to each other, in effect?

Mr. KUSSEROW. Well, they are going to run it all through a black box. One of the contractors will act as prime and will take data from the three different systems and run it through their black box to integrate the data. It is to then be instantaneously posted in the beneficiary's account.

That sounds really good on paper. Unfortunately, my experience with new Government systems makes me feel that I am perfectly safe in saying that I will resign in 1991 if it does work, because it would be the first time in the history of Government we have gone live with a system of this size in 18 months. I have never seen it in any agency of the Government, I don't think we can do it, especially since this is first time out for HCFA.

Chairman GLENN. Is the Department of Justice memorandum interfering with your ability to investigate the fraudulent receipt of Social Security cards?

Mr. KUSSEROW. Well, it places a cloud over the whole thing. The irony here is that last year, through the U.S. Attorneys, which are in the Department of Justice, we have prosecuted 1,325 individuals successfully. So, we are working with them, and I have seen no change with regard to the Department of Justice in their Criminal Division and U.S. Attorneys. They continue to take our cases.

But I would submit to you, Mr. Chairman under the test that you laid out in your opening remarks about our having jurisdiction only when it involves either an employee of the Department or a beneficiary or contractor receiving program dollars, if somebody is bribing a Social Security employee to obtain a Social Security card, there is no question that we have jurisdiction.

But what happens if as we find in much of the country, there are people who are smuggling in undocumented aliens and have a scheme to obtain Social Security cards fraudulently. We have a number of investigations along that line. If we don't identify a Federal employee at the front end of this investigation then we don't have jurisdiction, if you take a strict interpretation of the OLC opinion.

To illustrate more clearly, we have identified a number of different counterfeit rings that manufacture phony Social Security cards. They, too, are not beneficiaries, they are not contractors re-

ceiving program dollars, and they are not employees. Therefore we don't have jurisdiction.

Understand, the Social Security card does eventually lead to a benefit for elderly Americans. The Old Age Survivors Insurance Trust Fund provides a retirement benefit, and we have Medicare. But, by and large the other important thing for a Social Security card is that it is one of the major foundation identity documents that, along with the birth certificate, allows people to do almost anything. If you are involved in espionage cases, you are going to be finding people wanting foundation documents to hide illegals. If terrorists come into the country, they need documentation. They will need a birth certificate, and they will need a Social Security card.

Chairman GLENN. How much of a problem is it? Do we have any estimate of how many fraudulent cards might be out there? Have you got far enough into it we can make an estimate?

Mr. KUSSEROW. If we are talking about false and fraudulent cards, numbers that are operating, we are talking about perhaps as high as tens of millions.

Chairman GLENN. Tens of millions of false Social Security cards?

Mr. KUSSEROW. Yes, sir.

Chairman GLENN. Does the Department of Justice ruling on this, does that ruling hold you up on these investigations?

Mr. KUSSEROW. Well, nothing has held us up. As long as the U.S. Attorneys working for the Department of Justice, the Criminal Division, keep taking the cases and prosecuting them, then there is no problem. It does put a cloud over it, though, that eventually might become an avenue of defense to challenge whether the investigation was lawful and proper, whether the employees are operating within the scope of employment.

So what we have here is no immediate problem. There is not a single investigation that has been stopped or curtailed. But it creates a cloud for the future that needs to be resolved lest it become a major problem.

Chairman GLENN. How about following up on this Social Security thing just a little bit. Is there a Social Security problem with people who then emigrate? You didn't mention that, but I understand there has been some problem with that. What is it?

Mr. KUSSEROW. Well, basically that anybody coming to the United States to work or to open a bank account or to do anything really needs a Social Security number, and that you can get them legitimately. If, however, you have entered the United States—

Chairman GLENN. This is the other way I am talking about, not immigration, but emigration.

Mr. KUSSEROW. Well, yes, the same thing would be true. One of the things that we have found in looking at fraud against Social Security trust funds, is that oftentimes people return to their native soil after working in the United States. And we seem to find that by returning home to your native soil you never die. I mean, those program benefits keep going on forever and ever and ever, because how do you validate whether or not somebody dies?

If you go to Sicily and try to find somebody, how do you determine whether they are still alive? Or worse yet, we pay program benefits through some foreign government for individuals that are

on Old Age Survivors Insurance with Social Security. We are depending upon foreign governments to tell us when beneficiaries die. Well, Social Security is a major source of hard currency. I just don't see that there is much more motivation for them to report deaths.

So we have a problem there. We also have a problem when an individual who needs a Social Security number and who may not be entitled to one for various reasons, may also want to establish legal residency in another country and use the American documentation to help them do so. Understand that if you have a Social Security card, and are able to get a fraudulent birth certificate, you can then get a passport, and a whole new world opens up to you.

Chairman GLENN. Do we have any way of estimating, or do we have an estimate on how much of an emigration problem this is, or how much of a problem that gives us? Do we have any estimate of the amount of money that goes out and is paid continually to people that have already died abroad and we don't know about it?

Mr. KUSSEROW. No, and the reason for that is we depend upon the State Department to validate it. If case officers with the State Department will go into rural Mexico or Philippines, how do they know whether the individual there in fact is our beneficiary? Are they going to go to the local constabulary? Is the local constabulary going to stop the benefit going into a village? No.

So we really have no reliable data. Over a period of time we will be able to estimate. Since Social Security is a relatively new agency, having been established in 1936, we really haven't yet begun to see the full effect of—

Chairman GLENN. The only way you could catch up on it now would be if you have claims where people are obviously 120 years old or something like that.

Mr. KUSSEROW. And we have not gotten that far yet. Soon we will begin to get that kind of information, but people who entered the system in 1936 as a new worker, are not going to be 120 or 130 yet.

Chairman GLENN. The 1986 Program Fraud Civil Remedies Act provides for an investigating official, that is the IGs, to subpoena the production of information.

The 1978 Inspector General Act provided for the production of records and documents, but not the direct subpoena of witnesses per se.

Have you been able to subpoena the testimony of witnesses pursuant to that 1986 law, and if so, what mechanism is available to issue the subpoena?

Mr. KUSSEROW. Well, fortunately for us, unfortunately, for everybody else, the Program Fraud Civil Remedies Act was built on previous legislation established in our Department called the Civil Monetary Penalties Law. Therefore we are able to operate under that and we, in fact, do have the ability to compel testimony.

The difficulty is that under the Program Fraud Civil Remedies Act you cannot, and also under our criminal investigations or civil investigations we really cannot without the Federal grand jury. The difficulty we have is that we did a study some years ago of convicted practitioners, physicians, trying to understand why they committed crime, what was their opportunity and what recommen-

dations we could draw. One of the things that really came out is none of them admitted they did anything wrong. These were people who had been convicted. But, they believed it wasn't their fault. It was their billing clerk's fault or it was somebody else's fault, and they wouldn't take responsibility for it.

But interestingly enough, whenever we enter an investigation involving a clinic, a hospital, a pharmacy, or a nursing home, the witnesses are scared to testify. They are scared to come forth and give information because their own livelihood is jeopardized. The testimonial subpoena is not to compel testimony in 90 percent of the cases. It is to protect witnesses against retribution from their employers for cooperating. We do not have that, and it has a chilling effect.

It is very difficult to get a nurse or a billing clerk to testify against an institution or their boss without having that kind of protection for them. So this is, more than anything else, protection for the witness, not as a means to go against the wrongdoer. With the wrongdoer, you can get information through other means.

Chairman GLENN. Thank you. My time is up. Senator Cohen?

Senator COHEN. Thank you, Mr. Chairman. I have an opening statement I would like to insert in the record.

Chairman GLENN. It will be included in the record.

[The opening statement of Senator Cohen follows:]

OPENING STATEMENT OF SENATOR COHEN

I congratulate the chairman for holding these hearings to assess how well the Inspector General Act is working. The committee has had a long-standing commitment to the inspectors general and it is important for us to have the inspectors general report to us directly on their major on-going investigations and their recommendations.

I very much look forward to the testimony of the witnesses we have here before us today. In my years as chairman of the Oversight of Government Management, and now as the ranking member on that subcommittee, I have had first-hand experience with the importance of having aggressive, active inspectors general. The subcommittee has, for example, worked extensively the inspector general of HHS, Richard Kusserow, the first witness we will hear testimony from this morning, in such efforts as providing administrative remedies for small dollar fraud cases, and in the computer security and computer matching practices of the Federal Government. In countless cases, it has been an inspector general who has brought a management problem to the attention of Congress.

Having said this, I remain concerned that management problems, and indeed major problems in how entire Federal programs are operating, may go unnoticed by the Congress for too long. This certainly is true in the case of the scandal within HUD, the details of which are still unfolding. In that case, the inspector general indicated that management problems did exist, but, apparently, this did not catch the attention of Congress. I think it is necessary to admit that, in the HUD case, the responsibility rests on many shoulders: The inspector general, who must actively tell the Congress that serious problems exist, and the congressional committees which receive the reports of the inspectors general.

While I recognize that the inspectors general routinely provide reports to the committees, perhaps it is necessary for the committees to do more of what this committee is doing with these series of hearings: to frequently call the inspectors general before us to learn what the major problems are—and whether the agency heads are adequately correcting them. I hope that the witnesses today can provide us with some suggestions on how to identify and cure major problems in programs before the taxpayers lose millions of dollars due to fraud and mismanagement.

I also look forward to learning the witnesses' views on the Justice Department's opinion regarding the authority of the inspectors general. I do not believe that the Congress intended the inspectors general to duplicate—or supersede—the role of the agency itself in enforcing the programs within the agencies' jurisdiction. Still, it is important for the inspector general to investigate private parties to determine if the

agency is doing an adequate job of managing its programs. I have concerns that the Department of Justice opinion could have serious implications for the role of the inspectors general. I am very pleased that the committee is examining the effects of the opinion to determine whether clarifying language is necessary in the Inspector General Act to cure this problem.

It has often been said that the inspectors general are the junkyard dogs who are supposed to ferret out fraud, waste and abuse. The congressional committees and the General Accounting Office alone cannot reach within the agencies to oversee the agency's operations. If the IG's are to perform this function, it is important that they keep in close contact with the Congress and that the Congress is receptive to acting on their findings. It is also important to give the IG's the necessary tools, both in staffing and authority, to perform their role fully. I look forward to hearing the testimony on how well the IG Act is working and on ways to help the inspectors general in saving millions of dollars for the taxpayer.

Senator COHEN. First, I want to thank Mr. Kusserow for all the help he has given to the oversight Committee in the past.

Mr. Kusserow, would you recommend that we have some sort of a sunset provision on Social Security recipients who emigrate back to their country, so you have a cut-off date and then they would have to come forward and they are still alive, and still entitled to the benefit?

Mr. KUSSEROW. I don't know if I would call it a sunset provision, but I think it is a good idea is that periodically they should produce evidence of the fact that they are alive. And I think that it is not unreasonable that they be asked to come in to an embassy or consulate once every whatever period of time and present themselves to make sure that, indeed, they are who they say they are and that they are alive.

Senator COHEN. And a failure to do that would result in the termination of the benefits?

Mr. KUSSEROW. That's correct. I think that would be an excellent approach for the problem. I think it is very reasonable. You cannot have them do it every month, it becomes unreasonable, especially if they have to travel a long distance. But I think once every year or once every 2 years or 5 years or something like that. Pretty soon we are going to find that people living throughout the world, not just in Transylvania, will never die.

Senator COHEN. My understanding is that you sought and received delegation of authority from Secretary Louis Sullivan to pursue certain cases that you wouldn't have been able to pursue under Justice Department's opinion. Is that correct?

Mr. KUSSEROW. Well, we never thought that we had a problem—"we," meaning the Commissioner of FDA, the General Counsel for the Department, and myself. We discussed it when the issue was raised whether the OLC memorandum applied to us and whether we have the inherent authority to investigate these companies that are submitting drug applications, but they don't receive program benefits.

I would submit to you, Senator, that indeed you do get a program benefit once FDA approves your drug. It is worth millions of dollars. But the companies don't receive program dollars.

We never thought we had a problem. But, since it was raised we discussed it and we thought we would try to insure the bet so that we could remove whatever cloud of concern there might be. We went back to the original legislation. When the Congress created the IG's, they created the rubric under which to create and Inspec-

tor General office. But the Congress said they are not going to decide whether this validation person is a program accountant or an auditor, or that integrity person is on the program side or an outside investigator. Congress left that up to the Department to sort out, and over the years they have.

And the means by which Congress did that is language in the legislation that said that the Secretary, or the agency head, may transfer other investigative and audit responsibilities deemed appropriate to the Inspector General with the concurrence of the Inspector General.

So that is the approach that we went to Secretary Sullivan with. He agreed to it, and we had a program delegation. And then some question was raised about whether the Secretary has the authority to make those kinds of delegations, which I just think is outlandish. I think as the Chairman pointed out in his opening remarks, that we need clarification. Unfortunately, the institutional memory of the Congress fades a little bit as members retire and move on to other issues, and then people proceed to interpret what you originally meant. It is in these interpretations now we are having problems. So I think a clarification of what you intend is very important, not only in this area, but also in the area of general counsel authority and personnel authority.

No one had ever questioned that the IGs should be independent and freed to have their own general counsels. The attorneys in the Department only exist to handcuff people making decisions. The only thing that they do is say no, they don't know how to say yes. There is no risk in saying no, and a lot of risk in saying yes. So, we don't want the Inspectors General handcuffed that way. If they run into that kind of problem they would have their own authority, It was never questioned until now.

Now they are questioning our personnel authority and our authority regarding having our own counsel. I think we need clarification on it.

There are a lot of loose ends that seem to be emerging, not because there has been any problem in the past but because the understanding of the people who originated the legislation is fading a bit with time and people are interpreting what was originally meant 10 or 12 years ago.

Senator COHEN. Why do you say that the memories of the sponsors of the legislation, and of these who passed the legislation, are fading? What evidence is there of that?

Mr. KUSSEROW. Well, some of the members have retired. There has not been a reinforcement on some of these issues. I can't tell you how happy we as a community are that this Committee is holding this hearing and that it is focusing on this. You tell us what you meant, restate it, and that is the way we will go. If others interpretation of what you intended to mean is incorrect, tell them and then that would make us happy. If what they are telling us is correct, at least we will know the truth and then we can accommodate ourselves accordingly.

Senator COHEN. You mentioned the program fraud legislation that was passed, and you indicated you don't have testimonial subpoena power under that act.

Mr. KUSSEROW. No, we don't have that, or under any civil investigation. In the criminal investigations we have no problem because we have Federal grand Jury subpoenas to compel testimony.

Senator COHEN. Don't you have it in the small dollar cases, that is the right to go to an administrative law judge to seek a subpoena?

Mr. KUSSEROW. Yes, in the legislation that acted as the model for the Program Fraud Civil Remedies Act, the civil monetary penalty legislation, we had it. We have never had a problem. We have already collected over \$40 million in the last 3 years under that and we do have the ability. But when it goes before an administrative law judge then you can compel it.

Now, during the course of the investigation, however, when we go to people who maintain the records and ask them to explain discrepancies in the records, they are fearful of telling us because they could lose their job and they want protection. That is what testimonial subpoena would do; it would provide them protection.

The same thing is true, Senator, for the subpoena duces tecum for the documents. Oftentimes people say, I am glad to give you that, but can you give me a subpoena. That way I am protected.

So it is same thing. It is to protect the individual that you want to get the information from.

Senator COHEN. The IG of the Department of Defense has indicated to several of us that they are having some difficulty in getting information, that some employers are going to their employees saying, "Do not cooperate," and that the absence of this testimonial subpoena power is really impairing their investigation. I find it difficult to believe that we allow testimonial subpoena power for investigations of such statutes as the Horse Protection Act, the Egg Research Act, the Reasonableness of Bridge Toll Provision, but we don't have it for the Department of Defense.

Mr. KUSSEROW. You have some 64 authorities that you have conveyed on such things as you have described. One area where we have an absolutely sterling record is our evidentiary subpoena authority. You asked GAO on a couple of occasions to look at how we have implemented the powers that you have given us to subpoena for records. GAO said they have not found a single instance where it has been misused or there has been abuse thereof.

I think we are the best custodians for that. I think we build in very good controls to avoid abuse. I think that it is absolutely incredible that we are handicapped in such a way that we cannot seek the truth during the course of an investigation unless there is criminality. If we have criminality we can go to the grand jury and get a grand jury subpoena.

But when you are looking at fraud where the remedy may be civil or administrative, we are handcuffed.

Senator COHEN. We have got a situation now where we passed a new piece of legislation last year dealing with the clinical laboratories. We found that HCFA was totally unable to really investigate compliance with standards to date—

Mr. KUSSEROW. And we came forth with a report that reinforced that position rather forcefully.

Senator COHEN. Right. And so now we have a comprehensive law that regulates the clinical laboratories, including physician labs.

What is going to be the situation now with the requirement to really certify that the labs are complying with the law?

Mr. KUSSEROW. Well, let me just see if I can reverse it Senator. Let's say that during the course of our computer screens we see aberrant billing practices with regard to a clinic that is suggestive of false claims. We would go out and get a billing clerk who could be afraid to speak, because it could cost her her job. Yes, it will have a chilling effect. It will make it much more difficult for us to obtain the evidence. If indeed we can show criminality, malice aforethought, criminal conspiracy, and we can gather enough evidence to support that, we can go to the U.S. attorney and we will get a grand jury subpoena.

But in most of the cases what you are going to find is that through negligence, and indeed, it might even be willful negligence, they in fact are cheating the system but the case falls short of the threshold of mens rea or malice aforethought.

In those situations a testimonial subpoena would be extremely helpful.

Senator COHEN. Mr. Kusserow, we have had a report that was issued in March by the Office of Investigations of the IGs indicating in which some of the IGs are having some real problems as far as their own safety is concerned, not having the advantage of arrest powers, search warrants, firearm authority. And that report outlines a number of cases in which one agent was held hostage for some 45 minutes while purviewing a Social Security number fraud case. An Interior Department investigator was assaulted and his life placed in some jeopardy. And so there is a request that has been made that perhaps they ought to have additional powers.

What is your judgment on that?

Mr. KUSSEROW. Well, about half the IG people in fact have law enforcement power, through a variety of means. Agriculture has it through legislative action. We do not. I would submit to you it is far less risky going out to rural Iowa and talking to somebody about some problems they may have there than in some places in urban America where our people go.

When I was in the FBI in Chicago I went into some very, very hard areas, but I had two friends with me, one on my hip and one on my partner. And we are asking our people to go out to that same area by themselves without being able to protect themselves. It is almost unconscionable. And yet we produce criminal convictions. I mentioned last year we obtained 1,325 criminal convictions, and this is competing with other cases.

Many of our convictions are in the drug related area. When people are between fixes, they go to prescriptive drugs, and they go to Medicaid mills. They go to clinics, and we are involved in a number of drug cases. In one case alone we had 32 convictions of drug diversions involving those kinds of pharmaceuticals that would carry somebody from one fix to another.

Our people are doing that without benefit of arms. I also would point out to you that we have the highest percentage of any law enforcement agency of women special agents. It is bad that we have anybody go out to do that kind of work without protection, much less that we ask women to do this kind of work and not even be able to protect themselves.

We ask our people to do exactly the same thing that I did when I was in the FBI and they don't have the benefit of being able to protect themselves. And I would also submit that when we go in on an order of the U.S. District Court to conduct a search, the court wants us to be armed because you are charged with protecting the premises against anybody who may want to stop us from making that search. So that is another side of it. It is not just protecting ourselves, but protecting the premises.

When you have an undercover project and trying to ascertain whether people are selling pharmaceuticals in an unlawful criminal fashion and you are using cooperative witnesses, it is not fair to ask somebody do that for you when you cannot protect them. If you ask the question does it inhibit us, yes. Does it endanger us? Yes. Does it endanger the citizens of the United States that want to cooperate with the Federal Government? Yes.

It is a very, very serious problem for us. What surprises me is that with half the IG community armed already through a variety of means, including deputizations—we have a number of our people that are deputized—there has never been a single incident I have ever been aware of that has represented a problem. Our agents go to the same Federal law enforcement training center as the Secret Service, ATF, DEA, or all the other law enforcement agencies except the FBI, who go through their own Academy.

We receive exactly the same training as a Secret Service agent, as a DEA agent, as a Customs Agent. The only difference is that after we have our firearms training our people go back and are not allowed to protect themselves or anybody else.

On the other hand, I don't feel very strongly about it.

Senator COHEN. That and many other things. [Laughter.]

Chairman GLENN. Thank you, we will have a second round here and go 5 minutes on the second round, if that is okay, because we do have other witnesses this morning.

You mentioned in your statement the management of the Indian Health Service. The budget for that is \$1.1 billion, 85 percent you say is for health delivery services. And you say in your statement that you have found indications of theft, actual theft, and program mismanagement.

Can you elaborate on that a little bit?

Mr. KUSSEKOW. Yes, Mr. Chairman. We have found instances where some employees are involved in a lot of cheap theft, such as falsifying vouchers or being paid for services that were inappropriate. That comes as a result of not having proper document control on the vouchering process. We found an enormous abuse in that area, and we have convicted a number of people. I don't believe there is an SES'er in the Indian Health Service left in the Minnesota area as a result of the investigations we had there.

In addition to that, we have found a weakness in internal controls in the money that is granted to sovereign nations to assist them in developing health delivery services. We also have contractors that we pay to build Indian Health Services facilities and we have found that the process is just rife with all kinds of problems.

The only good thing I can say good about it is that the quality of the practitioners in the Indian Health Services is really unquestioned. The quality of services being provided to the Native Ameri-

cans is good and the outcomes have been improving steadily. The problem is in the processes surrounding it, not in the physicians or in the nurses that are in the system. The problems are with regard to the contracts, with regard to the financial processes that surround the Indian Health Service.

Until they started moving this year on correcting the problem, they probably could have applied to FEMA for emergency disaster aid, it was so bad.

Chairman GLENN. This Committee has taken the lead in the IG legislation in the past and was responsible for putting that into effect some 10 years ago and expanding it again last year. We are looking at other means of helping get better efficiencies in Government, too.

Do you think that the establishment of a Chief Financial Officer would help?

Mr. KUSSEROW. Well, Mr. Chairman, I have already gone on record with this Committee when you had the hearings on it before. The fact is I testified immediately following Director Miller, Deputy Director Wright, and you recall at that time they announced the Chief Financial Officer of the United States, Gerry Riso. I came right afterward and said that I like Gerry. He is a good friend, but he cannot do the job.

The CFO needs to be at a much higher level to be able to have the focus from that vantage point. It really needs to come from the White House, it seems to me, as opposed to one of the other agencies. I was on the Federal Financial Management Task Force of the AGA for 5 years, which worked to develop and explore the concept. The area where I am most heartened and where it really needs to start laying the foundation is in the agencies I would hope that this Committee would explore how the departments and agencies are experimenting with this concept, because there is a lot of movement afoot. It is uneven, but there are some best practices, and worst practices, that are going on and I think that it would be useful to explore it.

My concern with your previous hearing on that subject, Mr. Chairman, was that we seem to be preoccupied with who should be the Chief Financial Officer of the United States, rather than talk about how it should work in the agencies. It is sort of like trying to put the penthouse up before you build the foundation and put up the building.

There are a lot of things going on out there and it is fascinating to look at how agencies are working with it. Some are doing a good job, some are going at it badly, and I think it would be an excellent area for an oversight hearing to examine what is going on in that arena. But at a bare minimum, though, if you want to have a Chief Financial Officer of the United States, it has got to be at a higher level than what was contemplated and what was thought in the previous Administration.

Chairman GLENN. Well, we had a disagreement on where it should be located and that was the thing that sort of held it up here a year or so ago when we were looking into it. We expect to revisit that in the near future.

I could not agree with you more that it should be the responsibility of program managers, and not just your auditors, to identify

basic weaknesses and to establish internal controls in the Department. Your testimony shows that at HHS of the nearly 1,000 internal control reviews performed during the past year, no material weaknesses were identified by program managers in the five operating divisions of the Department.

Over the past 3 years program managers at Social Security have identified no material weaknesses, although your office has found them. At HCFA only one weakness was found by program managers over the past 3 years, your auditors found eight.

This suggests that the Federal Manager' Financial Integrity Act perhaps isn't working as advertised.

Was the HUD scandal a result of this, and would the scandal have been prevented if FMFIA were to be effectively implemented?

Mr. KUSSEROW. Well, I cannot really comment specifically about HUD. I am not really familiar with it.

Chairman GLENN. What do we need to do to make this more effective? That is the bottom line I am getting at.

Mr. KUSSEROW. Well, I think that we have begun to make a right move. As I mentioned in my testimony, a step in the right direction, is, the hearings we have had within the Department where program managers come forth and tell the Management Oversight Council what they have done and are questioned on the process. It is a step in the right direction.

I think that is very good. As a matter of fact, I would strongly advocate that OMB hold a similar type of accountability hearing, not unlike what they have for budget, for the management side, they could have someone come in from HCFA, for example, and say, look, you had 12 percent of the outlays of the Federal Government and you are paying all this money, going through contractors and everything else, and you tell us why you think you are running perfectly. I can't believe in this town that anybody would ever say that we are running perfectly.

I mean, you are just waiting for the first scandal to come along and then that makes you a liar. You know, it is only a matter of time before it is going to happen.

But I think the problem is, Mr. Chairman, that somehow, somewhere along the line an admission that you have something wrong is tantamount to saying that you are not doing a good job. Therefore, managers are reluctant, and especially in a transition year where you have new bosses coming in who do not understand the process. To come up and say, "gee boss, look at this, I have got a material weakness." Managers are fearful that such an admission might be misinterpreted as, oh, my God, we need to get rid of you too because we have material weaknesses.

Somehow we need to say that it is not a sin to uncover the material weakness. It is a sin to fail to uncover it. It is not a sin to report it, it is a sin not to have a corrective action plan. It is not a sin to have a corrective action plan, but it is a sin not to take the corrective action that you promised to do. This logic is lost somewhere in the system. I would submit to you, Mr. Chairman, that it is probably not working the way it was intended except in a very few pockets of the Federal Government. I think that if you talked to any Department you would probably find that it is falling way short of what was intended.

Now, as to whether that would make a difference, yes, I think it would make a big difference. It could have made a big difference in the generic drug approval process if they had identified material weaknesses there. If they had even had internal controls. I think it would have made a big difference in the Indian Health Service if in fact they had had an honest internal control program to look at how the program was operating and whether they had internal controls first. It makes a big difference. Now, whether it is an insurance policy against scandal, no, I don't think so. But I really think it reduces the threat of a scandalous situation many fold.

Chairman GLENN. Senator Cohen.

Senator COHEN. Just a couple of quick questions, Mr. Chairman.

Testimonial subpoena power, would you recommend that for all agencies?

Mr. KUSSEROW. Yes, sir, I sure would. As you were asking the question I was running through my mind all the different departments that have statutory Inspector Generals. I was trying to find an exception where it would not be useful, and I can't think of a single case.

Senator COHEN. How about the CIA? Isn't there a difference there when you are talking about having an agency which is precluded from action, theoretically, in this country? Practically, we hope that is the case as well.

Mr. KUSSEROW. Do they have a statutory IG there yet?

Senator COHEN. No, we don't.

Mr. KUSSEROW. Not yet.

Senator COHEN. Not yet.

Mr. KUSSEROW. If you have a statutory IG—

Senator COHEN. And the question is, would you want the statutory IG to be out issuing subpoenas in this country?

Mr. KUSSEROW. Well, in a previous incarnation I worked for that particular agency and I will tell you, it has a special mission and I am not the expert on it at this point. That is 20 some odd years ago that I worked there. But I will tell you that if indeed you had a process like that, the oversight would have to go through the kind of oversight you have for intelligence matters, because what you wouldn't want to do is have something that compromises the security of that agency and its mission.

So it would have to have some sort of special reporting provision on it. But I cannot imagine a single statutory office where a testimonial subpoena would not be useful and increase productivity. When you realize how many cases are lost because of a witness who wants to cooperate but is fearful of it. There is just too much need for this authority.

Just think about all the other agencies. For example, besides Defense, there are a lot of other departments that have the same contractor community. Energy uses the same contractor community. NASA uses the same contractor community. There are other contractors oriented agencies. You are going to be hearing from John Martin. EPA has a lot of contractors in their programs and in the Superfund. You could hear from any IG who investigates outsiders that are doing business with the Government, that periodically you need to have protection for the business employees.

Senator COHEN. Do you have any comments to offer about Congressional oversight? The Chairman mentioned that perhaps some different provisions or policies might have prevented the HUD scandal, but what about Congressional oversight? It seems that we have a situation where we don't follow-up promptly enough, we have reports filed by the hundreds on file here, and they are ignored.

What do you recommend in the way—

Mr. KUSSEROW. We have about 18 oversight committees in our Department. I average about 20 hearings a year. There is one hearing I would love to have each year. I would love to appear at a hearing before you once a year to talk about my performance.

The only problem with that is what the Chairman had pointed out. Maybe you would need another 500 or a thousand staffers, and maybe you would need to somehow clone yourself to be able to do all those hearings. Oversight hearings where you hold me accountable for the job that I am supposed to be doing at HHS and review the reports that I am mandated by law to give to you would be extremely healthy. It would be very helpful to you and helpful to me too, because it would reinforce the fact that our role is to report to the American people and to the Congress what is going on in our agency. I would love to have that. I just question whether you have the time or the capability to do it to that degree.

But having some sort of oversight hearing periodically on IG offices would be very good—not just on the whole community, but on us as individuals, and what kind of a job we are doing.

Senator COHEN. Should the IGs bring their investigations to Congress' attention earlier?

Mr. KUSSEROW. Well, it depends. If we see that the investigations are reflective of a larger problem, yes, I think we should. The one thing that we do not want to do is imperil any particular investigation and prejudice a defendant's right by giving away information that would hurt him.

I have been an Inspector General since June of 1981. I have never had a situation where Congress, once and we explained that we needed to protect the investigation, didn't fully understand that and go along with us. At the same time I can keep the Congress informed about the general thrust of an investigation. We did that with FDA and the generic drug approval process without endangering any of the investigations that we had in process. When we see a problem area where that the individual case is reflective of, I think that Congress should know about the background, rather than just the individual investigation.

Senator COHEN. Thank you very much. Thank you, Mr. Chairman.

Chairman GLENN. Just one additional question. With regard to CIA, would the CIA IG need subpoena powers over documents like other IGs? Will he be crippled if he cannot give such subpoenas to third parties who want to cooperate but cannot?

Mr. KUSSEROW. First of all, you don't need subpoenas for people within your own agency. You can just tell them to talk. If they want to raise their constitutional rights, they have a right to do that.

When you are talking about outsiders, I know who my outsiders are. There are 6,500 Medicare participating hospitals, 15,000 nursing homes, half a million practitioners. There are pharmacists, medical equipment suppliers, and so forth.

But who does the CIA deal with on the outside? If they are contractors, fine. But, I can't see them going overseas and subpoenaing a foreign Government, saying we want some information because we don't like the way that you have been dealing with us. I don't know how you could do that. So it is a different mission. If you wanted to have some sort of mechanism like that, you would have to tailor it to their mission. It would have to be different than what we have.

Chairman GLENN. Thank you. Senator Levin.

Senator LEVIN. Thank you, Mr. Chairman. I just had one question for this witness. And that is whether or not the Justice Department memorandum that is the subject of discussion here, whether that memorandum allows you to do oversight of the efforts of program officials to monitor compliance by private parties?

Mr. KUSSEROW. Well, first of all, I don't understand it. We have all seen the memorandum. But, I don't know what it means or doesn't mean. It is in the eyes of the beholder.

Senator LEVIN. In your opinion does it allow you to do that?

Mr. KUSSEROW. In my opinion, that OLC memorandum is not going to interfere with anything that I am doing right now. The question is that it puts a cloud over it. I think there is no question that I would still have the right, for example, in FDA to look at their program operation. The problem is how do you evaluate how well they are doing unless you go outside and look back on the program. That is where I could potentially have a problem. If I could stay within the agency that is fine, but if I wanted to go out to the drug manufacturing community and look at what they are doing in connection with our Department's action, then I couldn't do that, under a strict interpretation of the OLC memorandum.

Senator LEVIN. It is your interpretation of that memo that as part of your evaluation of how they are doing that you cannot go outside? Is that your interpretation of that memo?

Mr. KUSSEROW. If you take the literal interpretation that I cannot talk to or deal with anybody who is not a contractor or beneficiary receiving program dollars, or an employee of the Department, then I could not go out and talk to or investigate or audit or try to determine what is going on with the drug and device manufacturers.

Senator LEVIN. Are you saying that you believe it is unclear in that memo whether or not you have the power to go outside as part of your oversight of the efforts of program officials? Is that what you are saying, that it is unclear?

Mr. KUSSEROW. Well, it is not unclear in terms of FDA. As far as I am concerned, my Secretary signed off on the recommendation by the Commissioner of FDA and the general counsel of the Department. My instructions from the Secretary are that that delegation that he gave me—

Senator LEVIN. But for the delegation, put aside the delegation issue, is the memo unclear in your opinion?

Mr. KUSSEROW. Yes.

Senator LEVIN. It is unclear on the issue that I asked you about?

Mr. KUSSEROW. Yes, sir.

Senator LEVIN. Thank you.

Chairman GLENN. Thank you, Senator Levin.

Thank you very much Mr. Kusserow. I appreciate it. We do have to move on, we have other witnesses this morning. Excellent testimony, and I just wanted to let you know, too, we plan for this Committee to make a regular periodic review of IG operations like we are doing. The hearings we held the other day and we plan to hold in the future are pursuant to that. We are going to have more regular times when the IGs come up here and give us their testimony. We think that is a better way to keep on top of this whole thing. I think most IG's will welcome that.

Mr. KUSSEROW. I think I can speak for most IGs in saying that we would welcome it and sincerely appreciate it. Thank you.

Chairman GLENN. Good. Thank you very much, and we may have additional questions submitted by other Senators as a follow-up to today's testimony.

Our next witness is Mr. Raymond Maria, Acting Inspector General, Department of Labor.

Mr. Maria, we welcome you this morning, and if you will introduce your colleague there, we don't have his name.

**TESTIMONY OF RAYMOND MARIA, ACTING INSPECTOR GENERAL,
DEPARTMENT OF LABOR, ACCOMPANIED BY GERALD PETERSON,
ASSISTANT INSPECTOR GENERAL FOR AUDIT**

Mr. MARIA. Good morning Mr. Chairman. I am accompanied this morning by Mr. Gerald Peterson, the Assistant Inspector General for Audit, Department of Labor.

Chairman GLENN. Good. Proceed with your statement, or an abridged version thereof. In any event, the entire statement will be included in the record without objection.

Mr. MARIA. I would like to submit the entire statement for the record¹ and then summarize my remarks.

Mr. Chairman, members of the Committee, I would like to address two topics of great concern to the Inspector General at the Department of Labor, investigative authority and the need for independent counsel. I will also discuss briefly with the Committee current management and programmatic problems which we have identified at the Department of Labor.

The Office of Legal Counsel at the Department of Justice has issued a legal opinion on the criminal investigative jurisdiction of the Labor Department's Inspector General. This opinion was requested in September 1988 by the former Solicitor of Labor. At its inception in 1978 the Inspector General conducted fraud investigations in programs not always directly funded by the Department of Labor. Among these were claimant and provider fraud under the Federal Employees Compensation Act and the Black Lung Program, unemployment insurance claimant fraud and criminal violations of the Federal Longshore and Harbor Workers statute.

¹ See p. 232

These investigative endeavors produced a demonstrated record of successful prosecutions. In approximately 1986 the Inspector General responsibly began to assess other programs for their vulnerability to fraud and corruption. We identified 3 areas of significant vulnerability in which program agencies historically placed inordinate reliance on civil and administrative remedies to the virtual exclusion of criminal remedies. These areas are employee benefit plans, worker health and safety, and Federal wage and hour statutes.

In each area we believe a more credible enforcement effort can be achieved through judicious use of criminal investigations and resulting criminal remedies. In the pension and welfare plan area, the experiences acquired in the Inspector General's Office of Labor Racketeering have revealed that corruption extends beyond the traditional union affiliated plans and the traditional organized criminal element. Kickbacks, embezzlements, and extortion are occurring today in single employer plans and a new generation of racketeers has emerged in the form of attorneys, accountants, bankers, benefit plan administrators, portfolio managers, insurance providers and medical service professionals.

Clearly, fraud and corruption are not the exclusive province of union affiliated plans. Historically there has been no viable criminal enforcement program within the Pension and Welfare Benefits Administration, the agency in the Department of Labor with the primary responsibility for the enforcement of the Employee Retirement Income Security Act.

For example, in 1988 PWBA conducted fewer than 25 criminal investigations while opening nearly 1,600 civil investigations. In an effort to capitalize on the experiences of the Office of Labor Racketeering and improve the enforcement credibility of the Department of Labor, the Inspector General directed his Office of Investigations to pursue fraud and corruption in private pension welfare plans that are the basis today for the economic well-being and health of much of the American public. This decision produced significant criminal investigations of benefit plan corruption.

For example, earlier this year five persons associated with Lundberg Industries in New Mexico were indicted on fraud and embezzlement of over \$9 million from pension funds covering over 900 participants. In 1987 owners of a company providing services to a West Virginia pension fund were charged and convicted for defrauding the fund of over \$700,000. In 1987 a Pennsylvania medical plan service provider was indicted and convicted for submitting false claims to the fund in excess of \$200,000, not nominal amounts, a quarter of a million here, a quarter of a million there, it does add up.

With respect to worker health and safety, the Inspector General has found an appalling lack of criminal enforcement by the Occupational Safety and Health Administration. To reinforce this point, I will refer to a statement contained in a report issued last year by the House Committee on Government Operations:

Since the establishment of OSHA some 18 years ago only 42 cases have been referred by OSHA for criminal prosecution. Only 14 of those were prosecuted, resulting in 10 convictions with fines or suspended sentences. In the 18-year history of OSHA no one has ever spent 1 day in jail for a violation of the Act.

The Inspector General directed that efforts be undertaken to see if other ways could be found to punish employers who willfully jeopardize employees health and safety and lie to the Government about conditions in their factories and on their construction sites. The Inspector General reconceptualized the relevant fact patterns in terms of Title 18 criminal felonies, felonies such as false statements, mail fraud and conspiracy, whereas OSHA's compliance personnel are limited to the criminal provisions of Title 29, which are restrictive in scope, difficult to prove and carry only a maximum jail term of 6 months. I would point out that OSHA has never advocated a change to these Title 29 provisions.

It is essential, from the perspective of the Office of Inspector General, that criminal investigations and criminal remedies be factored into the OSHA equation to deter needless injuries and deaths. The Inspector General developed the first Federal case where an employer was sentenced to jail for health and safety violations. In this case the president of the Lancaster Battery Company, whose actions resulted in the permanent disablement of workers, pled guilty to submitting false safety certifications and was sentenced to 2½ years in prison. He was not charged with OSHA misdemeanors, but with Title 18 false statement violations.

I must point out that the United States Attorney did not believe that the investigation report submitted by the Occupational Safety and Health Administration was sufficient to sustain a criminal conviction and he specifically requested the Office of Inspector General to conduct a criminal investigation.

This sentiment is not an isolated one. Following the 1987 high-rise construction collapse in Bridgeport, Connecticut, resulting in 28 deaths, the United States Attorney for the District of Connecticut stated publicly, and "Simply put, the investigative process triggered by the collapse of the L'Ambiance Plaza was not designed to gather the kind of evidence necessary for a criminal prosecution."

In 1986, again, the Inspector General saw need for criminal investigation of various wage and hour statutes, including the Davis-Bacon Act, because Labor's wage and hour Division devoted very little effort to this area. In conducting these investigations we attempted to assist the program agency's civil and administrative efforts by making certain that restitution of back wages and debarment orders were included in all criminal plea agreements.

Our efforts to improve the enforcement credibility in Labor were met with resistance from the Pension Welfare Benefits Administration, Occupational Safety and Health Administration, and the Wage and Hour Division. Access to program files and personnel was delayed or completely refused, and occasionally program agency resistance escalated to deliberate obstruction of our criminal investigative efforts. I will cite an example which is still pending and very telling. A Wage and Hour field compliance officer notified the Inspector General's Office of Investigations that a subcontractor engaged in the construction of a nursing home, allegedly bribed employees to lie in order to reduce a proposed civil penalty under the Davis-Bacon Act. Information was also provided that the subcontractor had represented to these employees that he had, quote, "influence," unquote, within the Department of Labor.

An Office of Investigations special agent then assumed the role of a Wage and Hour compliance officer and in this undercover capacity developed evidence of bribery of employees and Federal officials as well as other significant Federal violations. This subcontractor and others essentially bribed the undercover agent, believing him to be a Wage and Hour compliance officer.

The investigation reached a point where cooperation from the Wage and Hour Division was essential to maintain the undercover pretense. When asked to cooperate by the Inspector General and the United States Attorney, the Wage and Hour Division delayed its response for over 6 weeks and refused to cooperate, according to advice they received from the Office of the Solicitor. During the meetings with the Inspector General, Wage and Hour and Solicitor officials told us they did not believe in criminal investigations and they said that their primary and only objective was the recovery of back wages. They also questioned the use of deceptive techniques such as undercover operations, which are legitimate and recognized techniques in the law enforcement community.

Their refusal to cooperate resulted in premature termination of this undercover operation and precluded the collection of evidence of certain violations, including fraud against the United States Department of Housing and Urban Development and lending institutions, fraud against the United States Department of Health and Human Services, which provided nursing home operators with certain reimbursements, bribery solicitation by local officials, payoff demands by labor union officials, and other significant Davis-Bacon Act violations.

It is ironic that rather than encouraging the Inspector General to conduct investigations in these areas, these three program agencies all resisted in varying degrees. Some believed that we were usurping their responsibilities and they complained about our efforts. For some the Inspector General was rocking the boat and disrupting the comfortable relationship that has too long existed between regulators and the regulated community. These sentiments eventually led the Solicitor to request, in September 1988, an opinion from the Office of Legal Counsel regarding our investigative authority.

That opinion, issued in March, essentially limited the investigative jurisdiction of the Office of Inspector General at Labor to those areas which were funded by the Department of Labor and those areas involving employee integrity. The opinion went further and said that the Secretary of Labor did not have the management latitude to delegate other authority to the Inspector General.

As a result of that opinion, we have suspended over 1,200 pending criminal investigations. This decision has been made despite our profound disagreement with the Office of Legal Counsel's analysis, but made on the basis of potential liability of our special agents.

The opinion issued by the Office of Legal Counsel interprets language in the Inspector General Act of 1978 regarding the IG's responsibilities. We are at the point where this Committee, the Congress as a whole, needs to tell the Inspectors General, needs to tell us what we should and we should not be investigating. In asking for this direction, I submit that if the Department of Labor Inspec-

tor General is not allowed to conduct criminal fraud investigations involving the Department's programs or involving programs which are not entirely funded by departmental dollars, the public will be ill-served, the American working force will be the ultimate losers.

I will try to explain why it is prudent from the perspectives of economy, efficiency and just plain good government why the Inspector General should investigate fraud and corruption in those agency programs which are not directly funded by the Department of Labor. Simply put, if the Inspector General doesn't do these criminal investigations, they will in almost all instances disappear. We do not contend that the Department of Labor program agencies fail to conduct any criminal investigations. We do, however, contend that there are not enough criminal investigations, not enough indictments, not enough convictions to achieve a credible deterrent.

Achieving a credible deterrent, practically speaking, is the only way to achieve broad-based compliance with the law. An inordinate reliance on civil and administrative remedies does not promote deterrence. That approach fosters nothing more than an environment in which the transgression is worth committing because the benefits are so high, the risk and costs of being caught are so low. Those who would consider committing crimes within this environment, within the environment created historically by the Department of Labor, need pause and ask only one question, "Can I afford the fine"?

There is a visible odium that accrues to being indicted, convicted and jailed. I submit that it is the specter of precisely this kind of disgrace which will add to the credible deterrent at the Department of Labor. Fines don't deter anyone. It would be worthwhile to study how many fines are imposed by the Government nationally and what the percentage of collection is for those fines.

If the Department were to tell this Committee that their attitude is changing and criminal enforcement will become a higher priority with additional resources being devoted to this effort, if they were to do this, it would take considerable time, time to obtain the authority to hire trained criminal investigators, time to actually hire them, time to have these individual educate themselves about the programs they will be investigating, time to secure effective relationships with prosecutors and over law enforcement personnel, and time to develop the necessary contacts and informants.

These promises regarding criminal enforcement have been made before by the Department of Labor and they have been broken. In 1982 the Department provided explicit assurances to this Committee's Subcommittee on Investigations that it would, quote, "Meet its responsibility to protect pension and welfare benefits against criminal exploitation," end quote.

Seven years later we believe this commitment has not been kept. Indeed, as we speak, there is a review underway in the Department of Labor of its enforcement responsibilities in theory with a focus on its criminal enforcement responsibilities. I have lost count of the number of reviews. I haven't seen any action nor do I believe has the Congress seen any action or good faith effort. We have heard this song before. I encourage you to approach it with a heightened sense of skepticism.

In this area of fiscal restraint and concern, it is not practical to reinvent the wheel to develop a capability which already exists. The Inspector General's Office of Investigations currently has the only GS-1811 series criminal investigators in the Department. It has developed over its 11 years of existence a broad knowledge of the Labor Department's regulatory programs and abuses which exist within them.

The Inspector General has the expertise and the ability to use the broad spectrum of criminal offenses found in Title 18 and we are willing and able to conduct these criminal investigations—not exclusively, but concurrently with the program agencies.

Let me emphasize that we are not attempting to acquire program operating responsibilities. We have no desire to duplicate, nor have we ever maintained that we have the authority duplicate, the compliance and regulatory activities of the Department of Labor. Simply put, investigations of criminal fraud and corruption are not synonymous with compliance and regulatory activities. When Congress enacts criminal laws, it does so with the belief that certain conduct is wrong and with the expectation that whoever engages in this conduct would be punished.

Further, I believe that Congress does so with the expectation that decisions regarding the initiation of investigations and the referral of cases for prosecution will not be politicized and will not be swayed by the relationship between regulators and the regulated community. I believe this was one of the basic reasons for the establishment of the investigative function in the Office of Inspector General.

And I might draw the Committee's attention to the skepticism articulated in 1978 by the Congress when at the urging of this Committee's Subcommittee on Investigations the Department Labor finally established a full time function to address labor racketeering. It was a good move, but based upon the investigation of the Subcommittee, the Congress wisely realized that to make that program a priority and to assure the integrity of its actions, to insulate it against political interference, outside interference and basic Byzantine intrigues in the Department of Labor, they took that program away from the Secretary of Labor and installed it in the office of Inspector General, again, to make criminal enforcement a priority and to give the program integrity.

Now, in 1989 we need to know if the Congress truly wishes to have a vigorous, objective criminal enforcement capability within the programs of the Department of Labor and whether or not the Congress wishes to tell individuals who fraudulently obtain Government benefits that they will be detected and prosecuted.

Who is affected ultimately by the three areas that the Inspector General has singled out for vulnerability? In the area of pension and welfare plans, we are talking about individuals, retirees, people about to retire, working people who collect their health benefits today. We are talking about dreams, expectations. How secure are these people today? How secure are they in the evening when they go to bed thinking they have junk yard dogs in Washington looking out for their welfare? I submit the junk yard dogs have no teeth if we abide by this opinion.

We are talking about workers, workers in construction sites, workers in factories, workers who are subjected to deplorable conditions. Who monitors these things? Who assures their welfare? It is interesting that the only professional criminal investigators in the Department of Labor repose in the Office of Inspector General. Historically we have with great vigor focused on union related crimes, but as I have said, are we to consider union related crimes—a pay off solicitation, an embezzlement by a union—are those crimes more egregious and deserving of virtually all the criminal investigative attention in Department of Labor? Are they more egregious than an employer who engages in reckless endangerment, indeed, makes his workplace not only dangerous but deadly?

And finally, with respect to wage and hour statutes, who is affected? Nobody except the people at the low end of the socioeconomic ladder, the people who most need the protection of Federal Government.

A word or two about independent general counsel for the Office of Inspector General. This is a major problem which we experienced in the Department of Labor in the past year. It is a refusal of the Secretary of Labor and the Solicitor to acknowledge the Inspector General's authority to hire his own attorneys under the Act, or to definitively respond to our request to internally transfer our attorneys from the Office of Solicitor to the Office of Inspector General.

Last December, after several incidents reinforced the belief that the need for independent counsel had become essential, Inspector General Hyland informed the Department that pursuant to his authority under the IG Act he was electing to transfer the legal services function from the Office of Solicitor to his own office. The 4 affected attorneys and a clerical literally were threatened and intimidated by the Office of the Solicitor, threatened with disallowance of wages and action to pursue that course if in fact the IG continued on with his proposed course of action.

The problems which led the Inspector General Hyland's decision to hire his own counsel remain. Any first year law student knows an attorney cannot serve two masters with competing interests. Our lawyers are in a position of inherent conflict on a daily basis and they are unable to provide us with truly high independent legal advice and representation. In turn, the statutorily mandated independence of the Office of Inspector General is compromised. Our office is simply not like the program agencies within the Department. We are expected to be a dissenting voice when necessary.

All the practical reasons supporting transfer beg the ultimate issue before this Committee today: What authority is granted to the Inspector General by the IG Act and specifically does it include the authority to hire independent counsel.

I would like to discuss briefly several major problems which we have previously reported to the Department and its program agencies in the area of management and programmatic issues. I believe the Committee is most interested in internal financial systems and controls. Unfortunately, we have found through the financial statements compiled and audited for the fiscal years 1986 through 1988

that the Department has significant internal financial control deficiencies. These deficiencies include accounting or internal control problems in such major areas as grants management, trust fund accounting, property, general ledger controls, and financial reporting.

Our audits have revealed that the Department's accounting system and other financial management systems do not fully interface and they possess significant information gaps. We are particularly concerned about grants management problems. For example, the Department's reliance upon grantee financial information which is unproven in accuracy and validity because DOL grantees account for over 85 percent of the Department's total expenditures. While the Department has stated that the implementation of a new departmental accounting system will alleviate many of these problems, it is important to realize the system is not yet operational.

With respect to individual Department of Labor programs, we are most concerned about the operation of the Job Training Partnership Act. Our audit work has shown that accountability at all levels of the program is lacking, and as a result Congress and the Department have no ability to comprehensively evaluate the program to determine if its intent is being realized. We believe that 6 specific areas need greater accountability—targeting, cost accountability, procurement, record keeping, reporting and monitoring.

In addition on our previously stated concern over criminal enforcement of employee benefit plan and corruption, we have also reported our concerns over the role of the independent public accountant in ERISA-covered plans. We have concluded in a 1987 report that the Pension Welfare Benefits Administration had not conceptualized how to integrate the role of the independent public accountant into the enforcement process and that they had not adequately instituted a quality control program to ensure that IPA audits performed on behalf of participants provide the maximum protection which these participants deserve.

In response to our suggestions, Pension Welfare Benefits Administration disagreed with our conclusions but did agree to establish the Office of Chief Accountant, who was to establish a quality control program. This office is in its embryonic stages and we will report back to you as the process evolves.

I thank you for your time this morning. Mr. Peterson and I are available for responses to your questions.

Chairman GLENN. Thank you very much, Mr. Maria. That testimony shakes you a little bit when you think of the implications of it from this side up here, too.

OPENING STATEMENT OF SENATOR NUNN

Senator NUNN. Mr. Chairman, if I could just make a very, very brief statement and put my statement in the record, I have got to open, as you know, a hearing of the Armed Services Committee so I have got to depart.

But in 1981 our Subcommittee reported the Labor Department's inquiry into fraud and corruption in the Teamsters Central State Pension Fund was poorly planned, mismanaged, and that they gen-

erally showed a lack of interest in criminal enforcement at the Labor Department. We had a long hearing, a long set of findings, and we also had a whole set of hearings on the International Longshoremen's Association. Again, we came to the conclusion that they were not enforcing the criminal laws and really had no intention to.

So what Mr. Maria has given here this morning is, unfortunately, a continuing testimony to the Labor Department's unwillingness to undertake seriously the criminal enforcement. They argue that the civil enforcement is what they need—and, of course, they do need civil, but I think they also need criminal. I hope that we will pay very close attention to this.

We have asked, Mr. Chairman, in our Subcommittee for a General Accounting Office report, which is underway now, on this subject. I don't know the exact status of the report, but my guess is it will be available this fall. So GAO is in a position now, or will be shortly, to report on this. I have known Mr. Maria a long time and he is always frank and candid and has been very helpful to this Subcommittee and the full Committee.

So I would ask that my whole statement be in the record, and we will get to the full Committee this GAO report as soon as it comes in, which is right on this point.

Chairman GLENN. Without objection the statement is included in the record.

[The statement of Senator Nunn follows:]

PREPARED STATEMENT OF SENATOR NUNN

I congratulate the Chairman for today continuing the Committee's review of the work of the Inspectors General throughout the government. Their function, as watchdogs for waste and mismanagement, is an extremely important one.

As part of this review, I understand that Raymond Maria, Deputy Inspector General of the Department of Labor, will be testifying this morning.

As I understand it, part of Mr. Maria's testimony this morning will focus on an issue which has concerned me greatly over the years in my work on the Permanent Subcommittee on Investigations. I believe Mr. Maria will speak to the alleged failure of the Department of Labor to devote sufficient attention to the criminal enforcement of ERISA violations. I wanted to take just a few moments this morning to point out that the Investigations Subcommittee has, in the past, found serious shortcomings in this same area at the Department of Labor.

For example, in 1981, the Subcommittee reported that the Labor Department's inquiry into fraud and corruption in the Teamsters Central States Pension Fund was poorly planned and mismanaged, following hearings that confirmed a lack of interest in criminal enforcement at the Department. At that time we said,

"[N]o other Federal component has the statutory and jurisdictional access to welfare benefit trust funds that the Labor Department has. The Department has the access for a reason. It is important enough to say it again: It is the clear and unequivocal intent of the Congress that the Labor Department has the front line responsibility to detect, investigate, and properly dispose of trust fund violations. The Labor Department's responsibility to detect, investigate and properly dispose of these violations applies to both civil and criminal cases. The issue is no longer arguable. The subcommittee hopes the Labor Department will stop resisting the will of Congress and start carrying out its mandate."

Later that year, in hearings on corruption in the International Longshoremen's Association, the Subcommittee again heard testimony that the Labor Department had not actively pursued criminal violations of federal labor laws, reporting,

"[T]he U.S. Department of labor has not taken an effective role in combatting corruption in national unions. . . . The Labor Department has primary jurisdiction in this area but has not met its obligations. It has neither created an adequate presence in the field; nor has it shown a willingness to build cases against allegedly corrupt union officials."

At the current time, the General Accounting Office is in the process of completing a report to be issued later this year to the Subcommittee which, again, focuses on the question of whether the Department of Labor has adequately pursued the criminal enforcement of the federal labor laws. The Subcommittee requested this report in response to recent reports, including the Inspector General's Semi-Annual Report, issued March 31, 1989, which indicated further shortcomings in this area in the Department.

In light of all of the above, I am particularly interested in hearing Mr. Maria's comments this morning on the question of whether the Department, outside the office of the Inspector General, has made a serious effort to actively investigate, or at least refer to the appropriate law enforcement agency, allegations of criminal activity in the labor-management field. In hearings before the Investigations Subcommittee dating as far back as 1957, we have seen ample evidence of the looting of pension plans and labor unions by organized crime and other corrupt labor racketeers. Given that history, it is today extremely important that government, and most specifically, the Department of Labor, do all that it can to insure that federal labor laws are adequately and vigilantly enforced.

Again, I thank the Chairman for calling today's hearings and look forward to this morning's testimony.

Chairman GLENN. Mr. Maria, in your statement you say the refusal to cooperate resulted in premature termination of undercover operations, and these were investigating violations of fraud against HUD and various lending institutions, fraud against HHS by virtue of inflated nursing home construction costs and reimbursement for services provided to patients, public corruption in the form of bribery, labor corruption in the form of payoffs, other significant Davis-Bacon Act violations.

There were some 1,200 investigations involved here. Is anybody working on those now?

Mr. MARIA. Those investigations have been suspended for the most part. There are a few which are in the pre-litigative or litigative stage where we would not term the agent's participation as active field investigation but merely assisting in the trial process. But no investigation is being conducted. These cases are being evaluated to determine their ultimate disposition. It is not an easy task because many of them are before grand juries, both at the Federal level and some at the State level, and precautions must be taken, the law must be obeyed with respect to proper disclosure of information that is before those bodies.

Chairman GLENN. The cases that are being suspended right now, you have 993 cases of unemployment insurance fraud, Wage and Hour Program fraud and abuse, Black Lung fraud, 49 cases, Longshoremen and Harbor Workers, fraud, OFCCP Program, fraud and abuse, mine safety fraud, OSHA, fraud and abuse, Employee Benefit Plan, fraud and abuse, alien certification Program, fraud and abuse. They are all part of that 1,200.

I don't know quite what to make out of that; because that would potentially be bigger than anything we have seen in the HUD scandal. Do you see it as being potentially of that magnitude?

Mr. MARIA. I am not certain it would have, taken collectively, that those cases probably would not approach the dollar value of what has been described in terms of the improprieties or irregularities at HUD. But the issue is who is affected in those various program areas and what kind of abuses will continue to occur?

The basic responsibility, I think, of any enforcement agency is the prevention of fraud, the prevention of corruption. Failing in that, it is our responsibility then to either fine or lock up the ras-

cal. If we don't conduct these criminal investigations, how do you signal to individuals that in fact the law is a worthwhile one, the law should be obeyed, and if you do not obey it there is a likelihood you will be caught and the punishment will be commensurate with the crime. I think this is common sense logic.

Chairman GLENN. Why do you think they made this request for defining your investigative authority? Why was that made without even asking your opinion on it or letting you know that kind of request was going to go ahead?

Mr. MARIA. Referring back to the comments in my statement, I am a professional skeptic. Some would classify me as a professional cynic. However, I believe the public is well-served by that mentality on my part. I think we have created an unsettling environment between regulators and the regulated community. I think I referred to rocking the boat.

Chairman GLENN. Do you think there was bribery involved? You indicate public corruption in the form of bribery. Is it involved in the people within the Department and those that are regulating?

Mr. MARIA. I wouldn't go so far as to say bribery.

Chairman GLENN. I am reading from your statement. You had listed several things there on the bottom of page 8 and the top of page 9, "Construction costs, reimbursement for services provided to patients, public corruption in the form of bribery, labor corruption in the form of payoffs, and other significant Davis-Bacon Act violations."

Now, what did you refer to there with that reference to bribery?

Mr. MARIA. I misunderstood your question. With respect to that example, I was referring to our initiation of an undercover investigation and essentially its premature termination and the kinds of violations we were precluded from gathering evidence about contemporaneous with the occurrence of the violation. That involved a Wage and Hour violation, and the bribery I was referring to is, yes, these were very blatant bribery solicitations by people engaged in the construction industry, bribery solicitations of an undercover agent that they thought was a Wage and Hour compliance officer. And these were not subtle solicitations at all. There was a shopping bag of cash. We are not talking about sophisticated laundry operations here.

Chairman GLENN. And the Justice Department's changing your investigative authority, in effect, stopped your investigation; is that correct?

Mr. MARIA. That's the way I interpret it.

Chairman GLENN. My time is up for this round, but this limiting Justice interpretation that your investigations can only involve Federal dollars directly spent by the Government or Federal employees, the intention and the intent of the IG Act and your activities and other IG's prior to this time was that you also were to look into carrying out the regulations and look at whether the agency was carrying out its role in that regard also. It was not intended to be limited just to Federal dollars and Federal employees directly.

Now, from what your testimony has indicated this morning, you are being completely limited in these other areas; you can't get into them at all.

Mr. MARIA. They have said that we have oversight responsibilities. They are saying that we can evaluate how well, for instance, the Pension Welfare Benefits Administration does, how well the Wage and Hour Division does, how effective the Occupational Safety and Health Administration is from an audit evaluation standpoint.

But they are saying that you cannot conduct criminal investigations of fraud and corruption. I think it is essential that we do that. I think we have to—the Congress has to arrive at some kind of agreement and provide some kind of imprimatur that says, yes, criminal investigations are important. And I am not, you know, to the right of Genghis Khan or Attila the Hun. I risk sounding that way.

But I think this must be factored into the enforcement strategy at the Department of Labor if there is going to be any credibility to the entire enforcement process. The question is, if you accept that, who will do it? Who is most qualified to do it? In this constricted budget environment, who is best equipped to do it?

Chairman GLENN. Well, you would think they would welcome your help and not squelch it. Senator Cohen?

Senator COHEN. Thank you, Mr. Chairman.

To what do you attribute this reluctance, indeed seeming abhorrence of criminal investigations into these issues, the OSHA violations, wage and pension benefits, what is the basis for it?

Mr. MARIA. Senator, the response is elusive. I can remember as an FBI special agent listening to taped conversations, racketeers, and expressing very little concern and in fact laughing about the Department of Labor, don't worry about the Department of Labor, when the question was raised about racketeering offenses, don't worry about them, our only concern is first the Internal Revenue Service, and then maybe the FBI. No one ever worried about the Department of Labor.

The Inspector General has, I think, made significant and highly recognizable strides in improving the enforcement capability there. What we are dealing with—and it doesn't matter which Administration occupies the White House, the Department of Labor has gone on its merry way. Collectively or institutionally there is an intellectual aversion and a visceral aversion to criminal enforcement. It doesn't see criminal enforcement as being part of its social goals. I submit that is specious reasoning.

Senator COHEN. In terms of the Office of Legal Counsel, where is that directive coming from? From the Justice Department?

Mr. MARIA. Yes.

Senator COHEN. You know, the President has talked very passionately about a thousand points of lights, but the Justice Department seems to be saying we want a single source of power. [Laughter.]

Is that over-simplifying it?

Mr. MARIA. Would you repeat the question?

Senator COHEN. I think it would lose a lot in the repetition. Let me move on.

I want to read from a report that was filed that says, "Despite the millions of workers and retirees dependent on ERISA-covered pensions, as well as the huge monetary stakes involved, the Sub-

committee found the enforcement ERISA has not been a high priority of the Federal Government. Rather, the Department of Labor's implementation of the law has been characterized by grossly inadequate resources, long-standing deficiencies, frequently changing and inconsistent leadership, shifting enforcement strategies."

And it goes in this fashion and says that the chances of the Department protecting violations of ERISA are minuscule.

Now, this is a report that Senator Levin, myself, and our staffs wrote back in 1986 when we conducted the first investigation of the entire ERISA program. And we were concerned, and I think it is something you touched upon during your opening statement, that there are a trillion dollars in assets in these pension funds and that was in 1984. I suspect it is considerably higher right now. In fact, I think the projections were by the year 2000 or so there would be about \$2 trillion invested. And yet, I think 1 percent—as I recall, it is roughly 1 percent of the plans were ever audited, and there is virtually no chance of detecting fraud or anything else in that entire program.

Has anything changed since 1986? It seems to me your language that you have used generally is the same as we used back in 1986.

Mr. MARIA. I think very little has changed. I am quite familiar with the report issued by your Subcommittee, and I applaud it. I think it is clearly an effort to raise a signal regarding vulnerability on a very, very important issue to a lot of American people.

There is a problem. Look at the universe. You have some 870,000 private pension plans, nearly 5 million welfare plans, and on any given day—a charitable amount—the Department of Labor can field—and that includes the Office of Inspector General—can field fewer than 300 investigative audit kinds of personnel. I am not talking about desk supervisors, I am not talking about people ensconced in headquarters of the Department of Labor. I am talking about people at the field level.

That is an imbalance. Now, how do we address that imbalance? And this is something that we have repeated many times, it is one of our formal recommendations. The basic answer is immediately add more people to the Federal payroll. That may very well be necessary. But first I think you have to demonstrate that you are getting the maximum return on investment out of your existing personnel, that your enforcement strategy is not flawed, and that your enforcement process is not fragmented.

One of our key recommendations involves the independent public accountant. He is critical to this enforcement process. We don't ask him to wear a badge, we don't ask him to wear a uniform, but sit down and ask, just what the hell is an audit supposed to do, what kind of comfort is it to provide plan participants? What are we paying for? To know that the figures in that financial statement foot and cross-foot? I think not.

We are looking for a comfort index there, and we have met resistance within the Department of Labor to implement our recommendations and, as might be expected, with regard to the American Institute of CPAs, we have met significant resistance. That was expected. I would have expected, however, that our colleagues in our own Department would have objectively viewed our recommen-

dations and seen them as a viable alternative to increasing the Federal payroll immediately.

Senator COHEN. If I could just ask one final question. Are you stating that there are a number of cases that should have been pursued criminally that were settled on a civil basis?

Mr. MARIA. I am saying in these particular programs—the three that I have highlighted—there are cases that have been addressed civilly where there are apparent fact patterns, fact patterns suggestive of Federal criminal violations. My concern is this about the process at the Department of Labor, who decides what the remedy is, what is commensurate with the crime? And when you find that 99 percent of your efforts are all tilted toward civil or administrative remedies, I submit something is wrong.

The challenge here is to fashion a process by which the Department of Labor achieves credibility by making certain that the remedy fits the offense. What occurs now is that it is predetermined what our remedies will be. The regulated community knows precisely what will happen when the Department of Labor knocks on its door, if they can be guided by history.

Senator COHEN. Thank you, Mr. Chairman.

Chairman GLENN. Senator Levin.

Senator LEVIN. Thank you, Mr. Chairman.

Your testimony indicates that the request which was made by the agency's Solicitor to the Office of Legal Counsel in the Department of Justice in September of 1988 was made without consultation of the Inspector General and was, quote, "Framed in a manner which could only be responded to in the broadest fashion."

Now, did you receive a copy of that request when it was made?

Mr. MARIA. Mr. Peterson can correct me if I'm wrong, we received a copy after the opinion had been requested and after the request had been made.

Senator LEVIN. But before the opinion was rendered?

Mr. MARIA. Yes. I would like to submit for the record, I am not certain that we formally received a copy or if it was informally given to us.

Senator LEVIN. Were you aware of the fact that it was phrased the way it was prior to the opinion being rendered, so that you could have attempted to change the formulation—you can't change the request—but that you could have perhaps sent a letter to the Office of Legal Counsel saying, hey, wait a minute, that request is framed much too broadly, you should address this issue as well; did you think about that possibility?

Mr. MARIA. My memory is somewhat vague on the chronology of events. I do know that we responded to the Department of Justice. I would like to respond for the record to this question so that I am accurate on these particular details, bearing in mind that I was the deputy at that point in time and not involved in each and every discussion between the Office of the Solicitor and The Inspector General. But I will submit for the record an accurate chronology of events.

Senator LEVIN. And also whether or not the Inspector General made any effort to alert the Office of Legal Counsel that the request was framed in a way that could only lead to broad conclusions. Let us know that for the record, too.

Mr. MARIA. Yes. I can tell you this, that the Inspector General did write to the Office of Legal Counsel expressing certain objections and raising his concern about inaccuracies and distortions before the opinion was written.

Senator LEVIN. Can you submit a copy of that letter to us, if we don't already have it?

Mr. MARIA. Yes.

Senator LEVIN. Now, as part of your oversight responsibility have you reached the conclusion that the Department of Labor is not adequately carrying out the mission that it has because it is inadequately using criminal enforcement? Is that your opinion?

Mr. MARIA. That is a fair opinion. That is a fair characterization of our opinion, yes.

Senator LEVIN. Now, if the purpose of your direct criminal investigations is to either support that conclusion or reach a different conclusion, but if the purpose of your criminal investigation is part of your oversight responsibility of the adequacy of the agency's function, do you believe that the Office of Legal Counsel would object?

Mr. MARIA. I don't believe so.

Senator LEVIN. Why then do you not take the position that the purpose of those criminal investigations that you have now put on hold is to help you ascertain the extent of the deficiency of the agency's activities in that area?

Mr. MARIA. If you will indulge me, it seems like a rather circuitous or indirect route to get to the appropriate point. And I think we ought to, you know, rather engage in somewhat of a perhaps tenuous or abstruse argument or rationale, I believe in confronting the point head on.

Senator LEVIN. Well, but it is a very important point, it seems to me. The language of the Office of Legal Counsel is that the Inspector General has an oversight rather than a direct role in investigations and one way of accomplishing your goal of carrying out those criminal investigations is to argue—and I think it is a very good argument—that the reason you are doing it is as part of your oversight responsibility of the Department. And that is essential as part of your oversight responsibility.

It is indirect, it is not direct, because the purpose is to help you reach a conclusion as to how well the agency is carrying out its responsibility, but it achieves exactly the same end, it seems to me, and it is consistent with statute, even by my reading of the Office of Legal Counsel. Why not take that position if it seems to accomplish your goal?

Mr. MARIA. I think it can be argued, and I think it could accomplish our goal. The problem arises in that the Office of Legal Counsel opinion has clouded the issue of legitimate jurisdiction, raising a real question about civil liability for our special agents. You know, the criminal investigative process is very intrusive and, as I said, it is a litigious society. The likelihood of being sued, there is a realistic likelihood that agents will be sued.

The point is this, under the Federal Tort Claims Act, if they are sued discharging their legitimate jurisdiction, the Department of Justice will defend them. If the Department of Justice believes that they are outside their jurisdiction, at risk are their possessions, and

more importantly, it will be their responsibility to hire their own counsel.

Senator LEVIN. Mr. Chairman, my time is up, but may I ask two more questions?

Chairman GLENN. Go ahead.

Senator LEVIN. I think it is important that the Office of Legal Counsel answer that question, because if they answer the question as I hope they would, that you, like any other Inspector General, can carry out investigations as part of your oversight responsibility, then it seems to me they have given you the green light to carry out the investigations and the assurance that they will protect you when you do so. So I believe that is the way the question should be framed to the Office of Legal Counsel. That is number 1, and if you don't frame it, I think the Committee may want to at least consider framing it, but that is up to our Chairman.

Secondly, you asked the question, who is best equipped to carry out those investigations? That was the way you just framed it this morning. May I suggest an answer which may surprise you.

I think the agency is best equipped to carry out the criminal investigations. That is a different answer than I think you would have given to the question at the moment you asked it earlier this morning. I think your point is that they are not doing it, rather than you are best equipped to do it.

Now, I don't consider that difference to be subtle, I consider that difference to be significant. But I would suggest that at least one possible answer to this dilemma is to answer the question that you raised this morning, who is best equipped to carry out those criminal investigations, by answering, "By God, it is the agencies, but they are not doing their job," or at least in this case you feel that they are not doing their job. And your job is to point that out, both to the agency and, if necessary, to the Congress.

And I also believe that as part of that job that you have that you have the right to carry out those criminal investigations to prove or disapprove your feeling, your conclusion, the allegation that there is inadequate carrying out of that function by the agency for which you are the Inspector General.

So that is not really a question, that is a comment, but I would urge you to let us know whether or not you will be asking that question of the Office of Legal Counsel that I have identified. If you don't feel comfortable asking it, then I would ask our Chair to consider asking that question for the Committee.

I thank the Chairman. I am way over time.

Chairman GLENN. Was this question of authority of IG's ever raised before, ever brought up to the Office of Legal Counsel from any Department as far as you know?

Mr. MARIA. We are not aware of any.

Chairman GLENN. Well, maybe they are just beginning to deal with it, because, you know, in the law last year we finally put an IG in the Justice Department, itself. I won't say that there is any direct connection nor would I argue against there being a direct connection, but they have had their own IG since April, and I don't know whether they may have invited questions to be raised or not, perhaps that's the case.

Last week Mr. Funk—who is IG over at State, he is also Vice Chairman of the President's Council on Integrity and Efficiency—testified that there are ongoing efforts with the Justice Department to reach a compromise on the issue of IG's investigative authority. Have you participated in those discussions or are you aware of what the discussions encompass?

Mr. MARIA. The answer to both questions is a categorical no, and I and my staff are personally outraged as a result of it.

I am not certain that all the—I am speaking only as the acting, all right. Many would interpret me as a interloper, so I can have perhaps the courage of my convictions, which others may not have. I perceive that all the Inspectors General are not marching to the same drum beat, they are all are not singing from the same song sheet. Some have very vigorous, very credible programs, and I think others have very comfortable situations in which their investigative authority is really of little consequence to them.

Chairman GLENN. Let me take a specific one here. Your testimony states there is accountability for the Federal funds expended on the Job Training Partnership Act program.

Why is there not any follow-up there? What are your recommendations for improving oversight in those areas? Is that an area that you were into on this fraud, abuse, bribery, misuse of funds and whatever? Can you give us some details on that?

Mr. MARIA. I will defer to Mr. Peterson.

Mr. PETERSON. On the JTPA, sir, that is an audit finding, not an investigative finding. What we had reference to is law itself requires that 70 percent of the funds appropriated for JTPA go for training. Instead of setting up a system that monitors that, over the last 6 or 7 years there has been no knowledge of how much of that is actually being spent on training, because instead of establishing a system, they established a contracting mechanism that allowed all of the cost of the contract, irrespective of where it should have been charged, admin and services, all of it to be charged to training.

So 6 or 7 years later the Congress nor ETA can in any way be assured that that 70 cents on the dollar that was supposed to be spent for training was in fact spent for training.

Chairman GLENN. There is no follow-up at all that monitors where the money went, whether it was used for its purpose or whether it was taken off and used to build roads and sewers or something else; is that correct?

Mr. PETERSON. Well, there is some follow-up, but it would not get to that limitation, to that limitation on the cost, and we think that it should be there. I think also that the Administration thinks it should be there now and we do see some signs of the current Administration moving to monitor that more vigorously.

Chairman GLENN. Well, we have to move along here. I appreciate very much your testimony, it has been excellent this morning—disturbing but excellent. And we are, obviously, going to have to follow-up on a lot of these items. We would appreciate your response to additional questions that may be submitted to you and we will be in touch with you further.

Thank you, Mr. Maria.

Mr. MARIA. Thank you, Mr. Chairman.

Chairman GLENN. Our next witness is Mr. John Martin, the Inspector General at the EPA, Environmental Protection Agency.

Mr. Martin, welcome. We look forward to your statement, and would you introduce your colleague for the record, please.

TESTIMONY OF JOHN C. MARTIN, INSPECTOR GENERAL, ENVIRONMENTAL PROTECTION AGENCY,¹ ACCOMPANIED BY LEE STEVENS, AUDIT MANAGER, AUDIT OFFICE, CHICAGO

Mr. MARTIN. Good morning, Mr. Chairman. I am accompanied by Mr. Lee Stevens, who is an audit manager with our audit office in Chicago.

Mr. Chairman, if I might I will summarize my statement to you this morning.

Chairman GLENN. Your entire statement will be included in the record and we would welcome your abridged version.

Mr. MARTIN. Mr. Chairman, I am pleased to have this opportunity to discuss our recent audit and investigative work at EPA relating to significant management problems facing the agency. Specifically, I want to discuss audits of the enforcement functions EPA, its construction grants program, and its contracts management program. I will also discuss a series of investigations into a very lucrative scheme of falsely certifying that imported luxury cars meet Federal standards. These audits and investigations focused on agency activities during the fiscal years of 1984 through 1988.

First enforcement. Since 1986 my office has issued several audit reports which contained an evaluation of the agency's compliance with its own enforcement policies. We found a common significant deficiency during our evaluations. Namely, we found that the agency is not vigorously enforcing its laws and regulations. To illustrate this, let me give you a few examples. We identified a wood preserving operation that produced railroad ties, foundation pilings and landscape lumber. Although five enforcement orders were issued for violations of discharge permits, not one penalty was assessed in 13 years of operation.

The violations that this facility produced caused a number of environmental problems, such as surface and ground water contamination. As a result, in June of 1986 the site was listed on the Superfund National Priorities List and the cost of the cleanup was estimated at \$23 million. Not until July of 1988 did the State finally revoke the discharge permit for this facility. More aggressive enforcement action might have forced the industry to act more responsibly and reduced or even eliminated the need for a Superfund cleanup.

Here is another example. A southern city was one of the region's worst violators of the Clean Water Act. The region computed a penalty of \$3.5 million for the city. However, the region settled for an amount of only \$36,000 and EPA could provide no support to explain the \$3 million reduction.

This is not an isolated example. We found that calculated penalties were routinely reduced during negotiations, sometimes in excess of 90 percent and amounting to millions of dollars with little

¹ See p. 263 for Mr. Martin's prepared statement.

or no documentation to support the reductions. In many cases the financial benefits the violators received from not complying with EPA regulations were not recovered through penalty assessments, making it economically advantageous for violators to be in violation of the law.

Inadequate calculation of penalties and insufficient documentation to support penalty reductions greatly raises the potential for fraud and abuse in EPA's penalty program. Also, GAO standards for internal control systems, which require that all transactions and events be clearly documented and the documentation available and easily accessible for examination were not met.

Additionally, EPA did not always follow up to ensure that corrective action was appropriately taken to bring violating facilities into compliance. For example, we found that EPA records for about 80 percent of RCRA violators we reviewed contained no clear evidence of compliance with RCRA enforcement orders.

The Committee requested that I comment on the overall vulnerability of the EPA Wastewater Treatment Works Construction Grants Program. That is an extremely difficult task. Literally billions of dollars have been spent in construction of treatment facilities across the Nation, and most of these expenditures have been good ones. In fact, on an overall basis, our office has only questioned about 2 percent of the costs involved.

On the other hand, not all projects have been a success. In many ways the successes and failures of the program to provide the needed wastewater treatment facilities have depended on the adequacy of state and Federal oversight of the construction grants program. Some states and regions have not always done a good job. For example, in 1986 we issued an audit report on Puerto Rico's grant program which disclosed that five regional wastewater treatment systems in Puerto Rico, costing more than \$200 million were not operating and were rusting away.

Other major systems which had received EPA funding for planning as long before as 1972 had little or no construction. These problems occurred because the agency constructing and operating the facilities lacked the managerial, financial and technical capability to operate the program. Further, EPA had not been sufficiently involved in getting these programs solved. Similar types of findings have subsequently been disclosed in reports on the Virgin Islands and Hawaii grant programs.

From what we have observed over the years, the success of the program seems to result from the commitment of the states and EPA to set up programs to simply ensure that, first, grant projects are truly needed; second the facilities are appropriate for the communities served and the waste to be treated; and finally, that the facilities built are properly operated and maintained.

Over the past several years our office has performed a number of audits that point to a need for EPA to more effectively plan, manage and administer its multi-billion dollar contracts program.

Next, I would like to discuss an audit we did of contracts in the Office of Policy, Planning and Evaluation. In an audit of a contract to provide general mission support to EPA, we found that 27 out of 211 subcontractors were either suggested or endorsed by agency employees. This is a violation of Federal procurement regulations.

In looking at the technical assistance team, we found out that professional contractor personnel were not effectively utilized to perform essential scientific tasks under the Superfund program. Instead, employees like engineers, scientists and geologists were performing routine administrative tasks such as file organization and answering the phone. During 1987 almost \$200,000 of such non-essential work was performed by these scientific personnel.

Concerning the field investigation team, we found that contractor personnel in the Superfund program spent most of their first year in the office, rather than performing on-site analysis work. We also found that EPA's Ratings of this contractor were over-generous and the contractor was paid award fees, even when work was less than satisfactory.

Since our audits focused on contracts in a number of major program areas and in several different geographic areas, we have concluded that the agency's contract management problems are not isolated to a particular program but in fact are widespread.

Now, concerning investigations. I would like to comment on the March 9, 1989 opinion of the Department of Justice Office of Legal Counsel concerning the authority of the Inspectors General to conduct regulatory investigations. In my view, this opinion chose the narrowest possible interpretation of an IG's authority, and so is unnecessarily restrictive. I can say unequivocally that I have never heard of any Inspector General who wanted to take over the regulatory investigations of his or her department or agency.

On the other hand, there clearly are investigative matters that IG's must pursue that do not fall neatly within the narrow bounds identified by the OLC opinion. This opinion would limit an Inspector General to investigate only allegations of fraud, waste or abuse among an agency's employees, contractors, grantees and other recipients of federal funds, or private parties who act in collusion with an agency's employees or other recipients of Federal funds.

This interpretation severely limits the broad mandate in Section 2 of the Inspector General Act that makes it the duty and the responsibility of each Inspector General to conduct investigations relating to the programs and operations of his or her agency. It is my job to ferret out fraud, waste and abuse in EPA programs, and I just don't believe that the Congress intended me to stop at the limits imposed by the OLC opinion.

Let me give you just one real example from my experience at EPA where a massive fraud was being perpetrated on the agency in a way that did not involve Federal funds or EPA employees. In 1985 the number of non-conforming, what is termed "gray market" vehicles imported into the United States rose sharply, from fewer than 2,000 in 1980 to about 68,000 in 1985. My office had reason to believe that many false certifications had been submitted to EPA concerning imported automobiles that had allegedly been modified to conform to EPA emissions standards. During 1985 my office, acting under its oversight authority to monitor the effectiveness of agency programs, initiated a limited number of investigations concerning entities involved in the gray market vehicle import business.

In particular, we scrutinized certain modification shops, testing facilities, and importers handling gray market vehicles. In doing

so, we worked with responsible state agencies such as the California Air Resources Board and with other Federal agencies, including the FBI and the U.S. Customs Service, and the Inspector General of the U.S. Department of Transportation. The result of this coordinated effort produced 73 indictments of individuals and entities involved in the gray market vehicle business.

In February, 1987, Auto Week Magazine, in an article entitled "Dark Days for Gray Market" credited these indictments as one factor which forced many importers out of the gray market vehicle business. During and after our investigations, the number of non-conforming gray market cars imported into the United States dropped from about 68,000 in 1985 to about 5,700 in 1988 and about 1,500 during the first 6 months of 1989.

Through the use of innovative investigative techniques in an area that the agency wasn't monitoring, my office had a deterrent effect on the massive fraud that had been perpetrated against EPA and the public. The recent OLC opinion limiting the OIG's authority to matters involving EPA employees or Federal funds would preclude my office from performing its proper oversight role to eliminate fraud and abuse, such as we have done in the gray market vehicle investigations.

Now, to conclude, the management team at EPA has acknowledged the problems I have discussed with you this morning and indicated its intention to take appropriate corrective action. You can be sure that our office is going to continue to perform audits and investigations in these as well as other EPA programs and to express our opinion as to the adequacy of the corrective actions taken.

Now I will be pleased to answer any questions that you have.

Chairman GLENN. Thank you very much, Mr. Martin.

On this falsely certifying imported cars, why was that done?

Mr. MARTIN. It is a simple economic fact out in California and other parts of the country that import very expensive vehicles, the importer for a fee—and sometimes the fee was rather large, running into the tens of thousands of dollars—would falsely certify to EPA that the vehicle had been modified, when in some cases it was impossible to modify, a certain type of vehicle.

That would allow the owner to register the car in the United States and use it. So we are talking about wealthy people that have very expensive vehicles which do not meet emissions standards.

Chairman GLENN. False certification, though, was done by the foreign manufacturer?

Mr. MARTIN. No, it was done by a facility in the United States that would be required to test that vehicle and modify it and then certify to EPA that the testing and modification had been done and that it now met EPA emissions standards.

Chairman GLENN. Is it your opinion that some of the people in EPA knew these were false certifications.

Mr. MARTIN. We never developed any information to demonstrate that was the case.

Chairman GLENN. You don't know then that there was any skullduggery or wrong doing within EPA, it was a matter of following up on the false certification by American companies that were certifying the cars coming in?

Mr. MARTIN. That is correct. EPA did virtually nothing to follow up on the certifications that were coming in.

Chairman GLENN. You said there was a city that was fined \$3.6 million for environmental violations, had its fine reduced to \$30,000; is that correct?

Mr. MARTIN. Approximately \$30,000, yes, Senator.

Chairman GLENN. This was what, an administrative fine?

Mr. MARTIN. Yes.

Chairman GLENN. Was it a regular court fine, administrative—

Mr. MARTIN. No. These types of fines are assessed by EPA according to their penalty policy. There is a negotiation that takes place between EPA and the violator and then EPA agrees to a final settlement.

Chairman GLENN. Well, what was the reason given for reducing a fine to less than one-tenth of what it originally was assessed to be?

Mr. MARTIN. Sadly in that case there was no reason at all, and as our review of case after case after case showed, there literally was no information whatsoever in the case file that would allow an outside observer to determine why a penalty of literally millions of dollars was reduced to a penalty of thousands of dollars.

Chairman GLENN. Can you give us an estimate of how many millions in reductions we are talking about and over what period of time?

Mr. MARTIN. No, I can't, and the reason is rather simple. EPA doesn't maintain that kind of information.

Chairman GLENN. Who does? Who maintains that information?

Mr. MARTIN. No one, to my knowledge, maintains it. Part of our recommendation to EPA is that if they are ever going to get a handle on how their enforcement program is truly operating, headquarters management needs to gather information like that, to assess across the country how fines are being calculated and mitigated and how these matters are being resolved.

Chairman GLENN. If there has been a fine assessed of \$3.6 million or whatever other amount and then it is reduced, you are telling me that there is no record whatsoever of why it was reduced, who reduced it, who the authority was that said we will reduce it from \$3.6 down to \$30,000; is that correct?

Mr. MARTIN. I am telling you that there is no record as to why it was done. Without any doubt, someone would have to sign a settlement agreement, so someone would be signing a bottom line, but literally in case after case after case that we reviewed, penalties were reduced 90 percent or more with zero justification in the file as to why that happened, or at best limited justification.

Chairman GLENN. So do we have the names of the authorities that we can hook to particular cases as to why the fines were reduced?

Mr. MARTIN. Senator, when our auditors asked that, which we thought was a rather basic question about why these penalties were reduced, the most common answer to why there was nothing in the file was that these were highly complicated legal matters that only attorneys would understand.

Chairman GLENN. I think some of we non-attorneys understand it pretty well, perhaps.

Mr. MARTIN. Well, this is the type of answer we received, that these are such highly complicated legal matters that you can only go from the assessed penalty to the final penalty without anything in between, otherwise the file would just be impossible.

Chairman GLENN. That seems rather ludicrous on the face of it to me.

Mr. MARTIN. Well, it certainly sounds that way to me, too.

Chairman GLENN. This has been brought to the attention of the top people in EPA and they have gone along with this system as a way of knocking these fines down to, as you say, sometimes reduced 90 percent from the original fine; is that correct?

Mr. MARTIN. That is right.

Chairman GLENN. And they have gone along with this.

Do they have full knowledge of this when you pointed it out to them and they just go along with that?

Mr. MARTIN. Well, we are now in a process of resolving those audit findings. The report that we have found most useful in this area was one that was just released a matter of days ago that I believe your staff has available here at this hearing. So we are attempting to get at that problem across the board in EPA programs. We think there is some agreement on the part of management to try to straighten out that problem, but we will have to wait and see.

Chairman GLENN. Does this enforcement problem and cutting down penalties and all, does this go through all of EPA's programs, or is it limited just to the clean air, clean water and the RCRA programs that were identified in your capping report?

Mr. MARTIN. Well, certainly those are three major programs of EPA and it definitely occurs there. We have also identified a similar problem in two other substantial agency programs, the Toxic Substances Control Act, TOSCA, and the Federal Insecticide, Rodenticide Act, FIFRA, and found that across the board penalties in those programs are routinely reduced sometimes 80 percent, so we think it is a pervasive problem in EPA.

Chairman GLENN. Does this just make EPA's enforcement program into a paper tiger?

Mr. MARTIN. Well, we have used words similar to that, Senator. I don't think that would be an unfair characterization.

Chairman GLENN. How about your own resources to perform audits, investigations of Superfund and other things, do you have adequate resources to do this?

Mr. MARTIN. Well, Senator, we have only about 50 employees in my office who are funded under the Superfund appropriation to do all the oversight of the entire Superfund program; that includes both auditors and investigators.

The Superfund program alone has many thousands of employees in it, as well as all the contractors and subcontractors and billions of dollars being poured into it. We have taken the position fairly consistently that we simply can't provide oversight of that program with the amount of resources we have.

As a matter of fact, in passing the Superfund legislation, Congress mandated that the Inspector General perform certain audit functions that it wanted us to report on every year. That mandated work takes up about 50 percent of the bodies that we have in the

IG's office to do that work, to do Superfund work, and almost all the contract money. So from a resource point of view, we have almost no discretion on things that we can look into.

Chairman GLENN. Recently we understand that top EPA management told OMB that EPA recognizes it must put controls in place to ensure the integrity of the whole Superfund program, in their words, "which inherently has great financial exposure," end of quote.

What type of problems have you found in the agency's Superfund program?

Mr. MARTIN. Well, I think that would probably be putting it mildly that the program has that type of exposure. You are talking about a cleanup program that is extremely technical, involves sophisticated—or maybe in some cases unsophisticated—contractors, subcontractors. It is basically construction work, clean up a site and make something disappear, not build a bridge, not build a hospital.

How much work actually went into the cleanup? How many tons of dirt were hauled away and new tons of dirt brought back?

If there aren't substantial controls over the program—and in some cases we found that unfortunately there are not—the whole program is susceptible to fraud to begin with. We have found excessive markups on labor and equipment costs, we have found contracts that were too large simply to accomplish the missions that were intended.

Chairman GLENN. What follow-up was there on things like that where there are criminal violations? What were the follow-ups on that?

Mr. MARTIN. Well, in any case where we found a criminal violation we have certainly actively pursued that, and we have found contractors that literally would bill EPA for work that was never performed.

Chairman GLENN. How many criminal cases have you referred?

Mr. MARTIN. I would have to submit that for the record, Senator, to make sure it is accurate.

Chairman GLENN. Can you give us a general feel for it, a few, or hundreds or thousands?

Mr. MARTIN. No, it is a few.

Chairman GLENN. What follow-up has there been to your capping report so far?

Mr. MARTIN. The report, as I said, has just been issued in the last several days. I will say that agency management has indicated to us that they recognize the problems that are identified in there. I believe the new Administrator of EPA has a serious commitment to the enforcement program. I think he has an opportunity here to make major changes to how the penalty process occurs in EPA, and I believe that with his own commitment that he will make an effort to see things are changed.

Chairman GLENN. Well, being primarily an enforcement agency, when you have enforcement that practically isn't carried out, or at least once there has been a fine put into place it is reduced to nothing, or 90 percent reductions are commonplace, not rare—they are the norm, I gather—it seems like forceless enforcement. You can't get much lower than that.

Mr. MARTIN. Forceless enforcement is a term that we used in one of our audit reports that generated out of the Philadelphia area.

Chairman GLENN. Senator Lieberman had a couple of additional questions here that I will ask on his behalf.

His number 1 question was, in your written testimony you mention your investigation of non-conforming gray market cars, cars with false certifications they meet EPA emission standards. In your view, does the OLC opinion preclude further work by your office on this investigation?

Mr. MARTIN. I would say that my good friend, Mr. Maria, who assured us just a few minutes ago before I got up here that I am not one of the IG's he identified as a paper tiger, has, I think, eloquently explained the problem that my investigators face from a personal liability point of view. As the IG, I can march ahead and pursue investigations, have my investigators do that work. Whether the Department of Justice will prosecute it or not is another question.

But as I do that, I think I have a responsibility to the people that work for me, and I think this legal opinion has cast a doubt over whether I can take the approach that one of the Senators here suggested earlier, that I could characterize the investigations as oversight investigations instead of just direct program investigations, and by that method be allowed to do them. That seems to me to throw the investigation itself into a very tenuous situation, and I believe that that is really my problem with the OLC opinion.

Chairman GLENN. Are you continuing to monitor enforcement of this automobile thing? That was his second question here. I will read his question directly.

You note that there are still non-conforming cars but the number of cars has dropped to 1,500 in the first half of 1989. Is anyone continuing to monitor enforcement on this issue?

Mr. MARTIN. We expect to go back into the program as a normal routine audit function. We do not see the program having the extent of the problems it had before, and I think the number of cars imported is a dramatic illustration of that.

Chairman GLENN. His next question was, do you believe that an express delegation of authority from the administrator instructing to continue this investigation would meet the requirements of the OLC opinion?

Mr. MARTIN. No, I don't. I disagree with some of my colleagues on this issue, but I don't think the Inspector General needs to look to the administrator, in my case, or a Secretary for a grant of authority. I think he has either got it or he doesn't have it. It seems to me if we are going to be independent, that this has got to be a part of our role and I wouldn't look to the Administrator for a delegation of authority.

Chairman GLENN. His last question was, are there other examples of investigations conducted by your office that in your view would now be barred by the OLC opinion?

Mr. MARTIN. I believe that we would be faced with very serious questions as to whether we could pursue investigations like we did in the gray market area without that opinion being resolved. I have expressed my opinion in various forums about that opinion, and I think it is simply too restrictive. I don't know the motivation

behind it. It doesn't comport with reality today, the job that the Inspectors General do in the Federal Government today.

Chairman GLENN. Is it your testimony that EPA's enforcement policies are so weak that it frequently pays for polluters just to keep on polluting and pay EPA's small fines rather than clean up their act?

Mr. MARTIN. Absolutely. I think that is an excellent characterization. We have found that over and over again.

Chairman GLENN. Well, obviously we have a great deal more work to do with you and the other IGs that have testified this morning. We appreciate very much your being here.

Mr. MARTIN. May I just raise one more question? I thought perhaps you would raise an issue about whether my investigators need the law enforcement authority. I have gone on record a number of times illustrating the fact that I think that is an absolute requirement for IG investigators. My investigators, as Mr. Kusserow explained to you, are trained right alongside of any other first class law enforcement agency in the Federal Government. They have a right to have that authority. There is no common sense reason why that authority is being denied to them today.

Chairman GLENN. Thank you, Mr. Martin. I appreciate it very much. It has been excellent testimony from all the IGs this morning. We obviously have a lot of follow-up to do on this Committee, and as I indicated earlier, we plan from now on to make these IG appearances before this Committee on a basis so that we can keep up with what is going on and give you the support you need. We think that is very important.

Mr. MARTIN. Thank you, Senator.

Chairman GLENN. Thank you very much. The hearing will stand in recess subject to the call of the Chair.

[Whereupon, at 12 noon, the Committee adjourned subject to the call of the Chair.]

SERIOUS MANAGEMENT PROBLEMS IN THE U.S. GOVERNMENT

THURSDAY, OCTOBER 5, 1989

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Committee met, pursuant to notice, at 9:40 a.m., in room SD-342, Dirksen Senate Office Building, Hon. John Glenn, Chairman of the Committee, presiding.

Present: Senators Glenn, Levin, Pryor, Sasser, Kohl, Lieberman, Roth, and Stevens.

OPENING STATEMENT OF CHAIRMAN GLENN

Chairman GLENN. The hearing will come to order.

Welcome to this morning's hearing on OMB's response to management problems in our Government. Director Darman, we are delighted to have you here this morning.

Today's hearing serves two purposes. Last Thursday and Tuesday this Committee heard from seven Inspectors General. Director Darman will tell us what attention the President and he are giving to these very disturbing reports of management problems in the U.S. Government. When I say "management problems," I put that very loosely; it gets into some very serious matters.

Secondly, we'll be following up on a commitment Director Darman made at his confirmation hearings here last January to come back later in the year and testify on his actions to revitalize the "M" in OMB, the management part of the Office of Management and Budget.

We already know about the procurement scandals at DOD, the fraud and mismanagement at HUD, the big ticket cleanup problems at Energy's nuclear weapons facilities, and the savings and loan bailout. Now the Inspectors General have given this Committee fresh warning signals, a new set of management problems. The Department of Energy IG just a couple of days ago described DOE contractors operating nuclear weapons production facilities under contracts so one-sided that once money is spent by the contractor, no matter how outrageous the expenditure, the Government simply pays up.

The NASA IG testified NASA is unable to oversee its spending, 88 percent of which goes to procurement. Inadequate contract administration allows subcontractors to reap excessive benefits and NASA subcontractors are not being subjected to competitive bidding.

The Labor Department IG—one of the most disturbing testimonies I have heard in here for a long time—stated flatly that Labor has failed to establish a viable criminal deterrence program to protect American workers' pensions, safe workplaces and decent wages, that there is widespread fraud and abuse in programs administered or overseen by the Department, and he concluded the Department is not meeting its mission to even enforce labor laws.

The EPA IG pointed to millions and millions of dollars of assessed fines which are reduced as much as 90 percent without any rationale, just reduced. He described EPA programs as "forceless enforcement," and EPA as a paper tiger with no deterrent effect on those who would violate environmental laws. He said it is quite often cheaper to pay the fine and go on polluting than it is to clean up the mess.

Health and Human Services IG pointed to fraud, outright fraud, in the Food and Drug Administration's generic drug approval process, the Medicare Secondary Payer Program, which he dwelled on, and the Indian Health Service. We have literally hundreds of millions of dollars involved in these programs.

He targeted a complicated procurement in the Health Care Financing Administration to manage prescription drug reimbursements which will cost over half a billion dollars to put in operation and predicted it will not work and offered to quit if it did.

I might add, in addition to my statement here, DOD talked about what in effect was sort of a scam where at the end of a fiscal year money was sent over to the Library of Congress for other purposes which could be used later on. In other words, sort of a mismanagement that they all participated in within Government itself.

These are just examples and they need top management attention. I'm sure, Mr. Darman, you will recall during your confirmation hearings we spent a considerable amount of time talking about the "M" in OMB. The "M" was put there in 1970. The idea was to place management on a par with the budget process. It has certainly not lived up to its promise.

This Committee has repeatedly asked your predecessors how do you get that management part of OMB to work? In the past the "M" has stood more for "moribund" than "management."

And I recall that you agreed with that observation. You commented that the director does tend to get sucked into the budget process, that OMB as an institution does not engage in the long term analysis it should, and that the short term orientation of the budget process tends to pollute the policy process follow-up that must be part of any good management.

You pledged to reserve time for the "M" in OMB and you agreed to come to testify about your actions on needed changes. During his confirmation, your deputy, Bill Diefenderfer, crystallized why management is so important. He stated that before the Federal Government can ask the American public to provide more money to pay for needed programs, it must convince them it can manage the programs taxpayers already funded. He saw that as the major meaning of the "M" in OMB. I think it is very good one.

In this regard, too, the financial management scandal at HUD is a bad omen. Your predecessor, Jim Miller, was recently quoted as saying that OMB was more interested in seeing programs eliminat-

ed than managing them. He further stated, "OMB was preoccupied with trying to terminate some of the programs at HUD rather than trying to police it."

I hope your testimony this morning will give us assurance that this is not a continuing attitude at OMB.

Testimony at our last two hearings by one IG after another—DOD, NASA, State, DOE, HHS, Labor, and EPA—has detailed not only inefficiencies and poor management practices, but actual criminal activity going unchecked. When these matters have been brought directly to the attention of those in charge, there appears to have been little or no interest in taking strong and immediate action to correct even apparent criminal activity as outlined by the IGs. And that is just indefensible.

To make matters even more unexplainable, or a better word might be "suspicious," the Justice Department comes out in the middle of all this with restrictions on IG investigations, the very investigations that have played the major role in uncovering most of the wrongdoing and criminal activity.

Now, what is going on here? This Committee has a responsibility to find out, and we certainly intend to do so. So, Mr. Darman, I understand that OMB representatives were present during the hearings that we have conducted and I'm sure you have been thoroughly briefed on what I consider to be shocking situations in those agencies. So I guess the bottom line question is what are we going to do about it, and that is what I hope you will address in your testimony today.

Senator Levin, do you have any opening statement?

Senator LEVIN. No, I don't, Mr. Chairman. Thank you.

Chairman GLENN. Senator Pryor.

Senator PRYOR. Mr. Chairman, I believe Senator Kohl got here before me.

Chairman GLENN. Senator Kohl, do you have a statement?

OPENING STATEMENT OF SENATOR KOHL

Senator KOHL. Thank you. It is good to have Mr. Darman back before us this morning. The topic of management is a broad one, it encompasses everything from the need for unified accounting standards in each agency to the need for more honest economic assumptions in your budget proposals, and my questions today will take the full measure of this meaning of management.

I must say that I started the year with much hope for this Administration. During your confirmation hearing I thought you struck a note that I liked very much. You said, Mr. Darman, that long term consideration should be the focus in the management of our affairs, we should set up priorities on a long term basis and endure the necessary pain in order to lead this country into the next century. Unfortunately, actions always speak louder than words and I must say that this Administration has continued some of the short term headline grabbing focus of the past Administration.

So I look forward to reviewing some of the things that have occurred thus far in your Administration and am eagerly anticipating your response. It is a pleasure to have you here, Mr. Darman.

Chairman GLENN. Senator Pryor.

OPENING STATEMENT OF SENATOR PRYOR

Senator PRYOR. Thank you, Mr. Chairman, for holding this hearing this morning.

Mr. Darman, I would like to say that the thrust of the issues I would like to raise with you this morning, or your staff, is not necessarily how much this is costing the Federal Government, which is certainly a major item, but most importantly, I think, it goes to the very fundamentals and the roots of our system of Government. I want to know today who is our Government.

No longer is our Government being run by political appointees and civil servants. Our Government today is being run, the policy is being managed and dictated, the speeches are being written, the testimony is being prepared, by outside Government contractors, private contractors who feed off of this system.

I have watched OMB directors for 11 years come before this Committee to state that we are getting ready to do something about this issue. We are going to retain the Federal policymaking decisions of our Government where they should be—made by Government employees and people responsible to this Congress and to the American citizenry.

In fact, in 10 years nothing has been done. The situation has gotten worse. The contractors are in a feeding frenzy. Let me give you an example. In a February hearing we found that EPA's Superfund program was relying not on Government workers but rather on contractors to do everything from rule writing to rule enforcement, the same contractors who simultaneously work for some of the major polluters of this country. In June we looked at the Defense Department's Office of Operational Test and Evaluation, which Congress created just a few years ago to evaluate the testing of the weapons that our fighting men and women will be using before multi-billion purchases are made.

What we found was that the same people who work with those who are making these weapons, who are producing these weapons, are now testing these same weapons. These are private firms; these are people with a possible ulterior motive.

When we consider governmental management issues, we need to be aware that the contractors and not Government officials often have effective responsibility for the most basic decision-making. Agencies claim that Federal employees and not contractors do the Government's basic work. However, in their own documents prepared by the consulting firms and the private contractors, we can readily see this dependence is rapidly becoming permanent, it is nearly total.

We see, for example that one of the contractors in its monthly report recently submitted its billing to the Department of Energy for staff services. BDM prepared the draft of a statement used by Secretary Watkins in his appearance on April 3 before the House Armed Services Committee.

In addition, SMS and BDM as a subcontractor, reviewed testimony from the Justice Department and EPA, along with draft legislation. Listen to this, Mr. Chairman, I'm sure you didn't know that

when you drafted legislation that your bill was sent to these contractors for their review and analysis. This is outlined in their monthly report to the Department of Energy.

This is true throughout our system of Government. "Yes," the agencies say, "Oh, we just get some advice." This is not advice, Mr. Darman, this is setting policy.

Department of Energy officials told my staff just recently that private contractors are not used in preparation of Department testimony. However, all we have to do is look in one of the newspapers on Sunday, September 17, 1989—just a few weeks ago—in the Washington Post, "Wanted" section SMS, the same group that reviewed Senator Glenn's legislation, and he wasn't even aware of it. Here is what they want. Here is what you apply for: "Duties for these positions includes assisting the Department of Energy with legislative analysis, document coordination, testimony preparation and review, floor statement development, and preparation of position papers."

Now, Mr. Darman, I want to know who is our Government today? That is in the Washington Post. When EPA, for example, issues new rules in the Federal Register—this is the Federal Register, dated September 27, a week ago—they say here is where you apply. You call this phone number, 202-554-1404. Do you get the EPA? Do you get the DOE? Do you get the Department of Transportation? No. You get a private consultant. You get a private contractor who answers that phone. They are doing the screening. They are doing the hiring. They are doing the recommending. So my question is, who is our Government?

And, Mr. Chairman, I have a long statement I would like to have put in the record. I am not going to take the time of the Committee, but I will have several questions for Mr. Darman.

I thank you, Mr. Chairman, and my colleagues for being so patient.

Chairman GLENN. Without objection, your entire statement will be included in the record.

[The prepared statement of Senator Pryor follows:]

PREPARED STATEMENT OF SENATOR PRYOR

Mr. Chairman, I would like to commend you for holding this series of hearings on management problems in the government. Before we can begin to concern ourselves with improving government management, we need to know who the government really is. For over a decade I have been examining the government's growing reliance on contractors to perform its basic work.

In a February hearing, I found that EPA, especially in its Superfund program, was relying on contractors to do everything from rule-writing to rule enforcement. These same contractors simultaneously work for our major polluters. In June we looked at the Defense Department Office of Operational Test and Evaluation which Congress created to provide an independent evaluation of weapons systems *before* multibillion dollar purchases are made. There, too, we found that the evaluations were turned over to private contractors who simultaneously work for the private firms whose products are to be tested.

As we consider governmental management issues, we need to be aware that contractors, not government officials, often have effective responsibility for the most basic decision-making.

Agencies claim that federal employees, and not contractors, do the government's basic work. However, their own documents readily show that this dependence is rapidly becoming permanent and nearly total.

For example:

In June, EPA staff declared that the termination of a single contract would bring EPA's RCA (Resources Conservation and Recovery Act) enforcement program to a standstill. I will insert in the hearing record an EPA memo that spells out EPA's stark declaration of reliance on a single contractor.¹ I note that this is only one of literally dozens of similarly sweeping contractor arrangements relied on by EPA.

Department of Energy officials told my staff that private contractors are not used in the preparation of Congressional testimony. Indeed, Energy rules prohibit the use of contractors in this regard. At the same time, the Washington, Post want ads show that anyone wishing to prepare DOE testimony need only apply to the right contractor.

When EPA issues new rules in the Federal Register, it lists seemingly official telephone numbers to call for additional information. In fact, if you call the number, you will reach private contractors, not EPA's employees, who will "interpret" environmental law and EPA rules for you.

How can the public find out who is managing its government? Incredibly, it often cannot. I have found that the more an agency relies on private contractors for basic decision-making, the more that everything they work on—that is, the basic work of government—is being withheld from the public as a "business secret." Indeed, even the names of contractor employees, as well as their private interests, are withheld from public disclosure as "confidential business information." If the job was being done by federal employees, their names, salaries, job descriptions, and much more would be available to the public. The opportunity for accountability would, at least, exist.

Does OMB know how much of the official work product of agencies, from testimony we hear in Congress to regulations that OMB reviews, reflects the work of private contractors?

Does OMB know whether these contractors simultaneously serve private interests that might benefit from this work?

Does OMB have the ability to assure the public that the "official" workforce is capable of understanding and controlling the growing private contractor workforce?

I am afraid, Mr. Chairman, that neither OMB Nor the Congress is aware of the degree to which the basic management of our government has been delegated to private contractors. In order to address the basic problems of government management, we must know just who our government is. It appears that our government is no longer, as our civics texts teach, the political appointee and the civil servant. I look forward to working with you in developing the basic "truth in government organization chart" so that Mr. Darman and his colleagues in the executive branch can begin to manage it for the 21st century.

Chairman GLENN. And what did you say that phone number was again? I may want to call it. [Laughter.]

Senator PRYOR. Here. I tell you, Mr. Chairman, after this session of Congress and the votes that we have the next few weeks, we all may be calling this number wanting a job. I may be. Thank you, Mr. Chairman.

Chairman GLENN. Senator Roth, do you have any opening statement?

OPENING STATEMENT OF SENATOR ROTH

Senator ROTH. Yes, I do. Thank you, Mr. Chairman.

I am happy to welcome you here, Mr. Darman. I don't know whether you are happy to be here, but, you know, the last time we met in this hearing room we were discussing ducks and the duck test. Well, I have a suggestion today that we ought to talk about the Big Mac. Combining management and accountability in the Federal Government, frankly, I think the Federal Government is having a Big Mac attack, and this hunger is consuming our Nation's resources. And both the Congress—and I want to underscore the Congress—as well as the Executive Branch have been reactive

¹ See p. 298 for the start of exhibits submitted by Senator Pryor.

in their management duties and oversight. Management has not taken the interest of either the Congress or the Executive Branch, primarily because it is not very glamorous and doesn't bring many TV cameras.

But both, as I say, have been reactive, and this is evident in the savings and loan bailout, the scandal at HUD, and in the many problems not glamorous enough to make the front pages of the daily news, yet costing the taxpayers billions of dollars in both time and money.

So I think it is time that we put the Federal Government's financial house in order and manage that house effectively and efficiently. The Federal Government is not having a crisis in any one agency but across agencies. We are lacking in management and accountability. I propose that we satisfy this Big Mac attack by an increased focus on management in the Executive Branch at the highest level.

And let me say on that point, Mr. Darman, this is not a new problem. Down through the years whether it is a Republican or Democratic Administration, the management functions of OMB have always played second fiddle.

We need the creation of a chief financial officer to give us an accurate reading of our financial situation and budget execution. I might point out that for years we have tried to get some kind of a standard accounting process through our agencies. We have got 25 different ones, I think, in the Department of Defense. I think that was the figure, Mr. Chairman.

How you are going to know what's going on in Government if you cannot even agree on standard accounting procedures is beyond me. But, of course, Congress hasn't wanted it. They have fought it—or some of the members—some of us have been very strongly in support, but others have fought it because it might give too much information about programs.

I think we need the establishment of a biennial budget process so that we have the opportunity to work on the management of Government. And that includes Congress. Congress has failed in its oversight. We never look at it systematically. We always highlight, pinpoint some local scandal because it makes headlines, and don't worry about the system. So that, lastly, I think we need increased oversight and focus by the Congress on the organization and management of executive agencies.

So, like the lettuce, special sauce and cheese for the burger, these are the ingredients needed to fix our management and accountability deficiencies. And frankly, Mr. Darman, I think you are the man that can do the job.

Thank you, Mr. Chairman.

Chairman GLENN. Thank you very much, Senator Roth. With your speech to the national press club you can now add Big Mac to your "Napo" concerns.

I have a statement from Senator Heinz who could not attend today's hearing and will insert it into the record at this point.

[The statement follows:]

OPENING STATEMENT OF SENATOR HEINZ

Mr. Chairman, thank you for holding this hearing and I join you in welcoming back to the Committee today's witness, the Director of the Office of Management and Budget, Richard G. Darman.

As we conclude this series of hearings on the implementation of the Inspector General Act and an overview of management problems within the Federal government, it will be useful to hear just how successful Mr. Darman has been in putting the "M" back into OMB and plans he has for the future.

I am sure you will agree, Mr. Chairman, these hearings demonstrate that much work remains to be done to increase the efficiency of the Federal government and prevent waste, fraud, and abuse. The Offices of Inspector General this committee has been so instrumental in establishing have proven successful. However, as illustrated by the HUD scandal, the crisis in the savings and loan industry, and the issues raised during these hearings, government management can tolerate improvements.

The inspectors general this committee has heard from over the past week have provided numerous recommendations which, if implemented, will improve the work of their offices. These suggestions included stronger law enforcement capabilities, increasing their independence with a set term of office, and in some instances a clarification of their mission.

The IGs have made it clear that necessary internal controls already in place are not being used to the full extent possible. This Senator is concerned about effective management operations not only in terms of government efficiency but also in the overall delivery of our government's services to the public.

An example of ineffective management mentioned during the previous hearing occurs with the Health Care Financing Administration's Point of Sale system for the prescription drug benefit. This situation highlights the lack of internal controls and accountability in the procurement process potentially leading to significant costs to Medicare. The HHS IG's remarks bring to light a delicate question of balance between an IG's duties and the responsibility of those implementing the program to ensure the viability of its internal controls.

I am looking forward to hearing from Mr. Darman regarding initiatives underway and those he plans to initiate at OMB to combat management problems in the Federal government.

Thank you, Mr. Chairman.

Chairman GLENN. Any other statements? Good. We look forward to your testimony, Mr. Darman. Thank you.

TESTIMONY OF RICHARD G. DARMAN, DIRECTOR, OFFICE OF
MANAGEMENT AND BUDGET ¹

Mr. DARMAN. Thank you, Mr. Chairman.

Mr. Chairman, I have, as you know, a rather long and boring statement and I would propose to offer simply a few summary points if I can in a formal way. I don't mean to treat the subject with less respect than it may deserve, I mean to allow more time to get directly to your questions.

Chairman GLENN. Your entire statement will be included in the record.

Mr. DARMAN. Thank you, Mr. Chairman.

It is, of course, a pleasure to be with you and the distinguished members of the Committee to discuss efforts to improve the management of the Federal Government. As you noted, during my confirmation hearings, I welcomed, Mr. Chairman, your invitation to return after 6 months and testify as to where we stand with the "M" in OMB. That is what I understand our purpose to be here today.

¹ See p. 282 for Mr. Darman's prepared statement.

With your permission—and I appreciate you having given me it—would offer just these few summary points; four points, in fact.

First, the management problems of the Federal Government are enormous. Whether governmental performance is better or worse than the private sector's after adjusting for the differences of scale is arguable. But it seems to me to be irrelevant. The governmental management problems are more than serious enough to merit greater attention. Indeed, they present not only issues of efficiency and integrity, but also issues that ultimately can affect the basis for confidence in democratic Government itself.

Second, the recently exposed HUD problems are not unique, not merely peculiar to that particular agency under what some have described as absentee management, nor are they peculiar, as some have suggested to this so-called "greed decade," the 1980's.

There are analogous problems in other agencies. In your introductory statement, Mr. Chairman, you referred to some; that is but a sample, as you know well, and the history of such problems is at least as old as the American Government itself. This is not to try to diminish the significance of such problems. It is, rather, to suggest, as Senator Roth has just suggested, that we must address them as, at least partly, systemic.

Third, among the systemic problems are failures of basic information and control systems, and failures of collective oversight. These stem in part from the inherent complexity of large scale Government, but they derive also from what seems to me to be part of a Washington cultural problem. I call it the Hollywood East syndrome. There are too many people in positions of political responsibility who are infatuated by the lure of glitter and lights, or the often illusory chance to, "make policy." And, as it happens, there are too few top level people who are interested in and too few local rewards for the more pedestrian work of nuts and bolts management.

Fourth, and finally, there is enough blame to go around widely, and OMB clearly must share in the blame. Notwithstanding the best of intentions, the "M" in OMB has suffered from too little attention over the years, too little attention within OMB, within the Executive Branch, and within the Congress. It has also suffered from too little in resources.

At the same time, however, OMB has a significant role and responsibility in trying to help reduce the problems that failures of collective oversight, including its own failures, may have produced.

We are trying to improve our capacity to meet that responsibility in ways that my prepared statement touches upon and that I will be happy to discuss. And, Mr. Chairman, I appreciate your having given me permission to include that prepared statement in its entirety in the record. I would be pleased to cede the time that I would take in reading it and use it for the purpose of trying to respond to your questions, and I'm, of course, available as long as you would wish.

Chairman GLENN. Good. Thank you very much, Mr. Darman. We will go on a 5 minute rule since we have several people here this morning, so we each have a chance to have a little give and take here.

I did read your whole statement last night and found it interesting. I would like to concentrate a little bit more on what happens to some of these IG reports, such as the ones we have. These are not new. They have been submitted to your office. They have been submitted to the agencies or the departments. And these are very, very serious matters, including fraud, criminal activity, and, in some cases, according to IG's, there was no action taken on these things, even after they were pointed out. Now, what happens when you get an IG report like that?

And let me just say going in, the IG system was put in some 10 years ago here as an experiment, and I think it has been one of the more successful experiments in Government, so much so that we expanded the IG cadre last year to include more departments and agencies. They have authority to go in and look at some of these situations from the inside, which we don't have the people to do from here. And their responsibility is to report to you, to report to the agency, and report to us.

In effect, they are our eyes and ears and your eyes and ears, just as much as people within OMB itself. And what happens to these IG reports? These were terribly important reports that we have been hearing about and apparently little or no action from within the agencies. What happens in your shop when you get one of these IG reports? What do you do with them?

Mr. DARMAN. Thank you, Mr. Chairman.

First of all, if I could just say, I agree with you about the value of the IG system. Indeed, I think I said when I was being questioned at the time of my confirmation hearings that I not only supported it fully but had done so since I was at Justice in 1973. I still do. I think the IGs would attest to the fact that they are getting very strong support from us.

That said—and the IG's are by and large doing a very important and good job—you are completely correct, in my view, that that work has not been taken seriously enough, often enough. And let me just divide this response into two parts, what used to happen, as I'm able to understand it, and what is now happening.

I'm afraid that what used to happen is that an awful lot of IG reports would not be taken seriously enough within their own departments by the political leadership within their own departments. And if one wants to look at symptoms of that, you can take the HUD case and notice that the IGs had identified and that the predecessors to the IG's—had identified elements of the problem in warnings years in advance of their actually being exposed earlier this year, and no adequate action was taken.

I have tried to do a survey of what has happened with other IG recommendations in other departments and what percent of those recommendations have adequately been acted upon, or acted upon at all, in a way that you could say disposed of the matter.

Unfortunately, the pattern of not paying enough attention to the IG reports seems to extend well beyond HUD, or to have extended well beyond HUD. I checked into what OMB, itself, had done in reviewing, not only the IG reports, but the related documents that you are familiar with. I believe they are provided also to the Congress, the documents that are required under the Federal Manager's Financial Integrity Act, FMFIA.

Those reports come annually to OMB, and, as you know, that's the system that formally engages the top management in stating whether there are material weaknesses internally. Those reports are supposed to be based on the IG reports, GAO audits, other information. Now, those reports would come over to OMB, and I'm sorry to report that OMB—I say with the best of intentions, I think what OMB has done—this may be a little bit unfair, obviously, I wasn't there—is basically take the report, check has it been filed—yes, or no; and if not, to get it. When they are all in and you got all the boxes checked, then you would say, how many material weaknesses were reported? You would have a column that says how many material weaknesses. How many of these are repeat material weaknesses? You got a column that says how many are repeat material weaknesses—how many are new material weaknesses? You got a column on what's the average age of the inventory of the material weaknesses? And, do a few other little statistical tallies and wait until next year.

Chairman GLENN. But what happens when there is a criminal activity?

Mr. DARMAN. Let me just say, this is what appears to have been the pattern. Now, let me explain how I have tried to change it.

Number one, I'm trying to give teeth to the FMFIA system. I called in all the Deputy Secretaries and then subsequently all the Cabinet officers—with the President in the case of the Cabinet officers—and told them we want them personally to understand they are accountable for those certifications. So when they say there is a material weakness or that there isn't a material weakness, they are on the line and they should expect to be the ones held accountable, internally and also, ultimately, in the press, if a problem blows up.

We instructed the deputies to meet with the IG's, the assistant secretaries for management, and CFO's within their own department and review the prior submission and review all outstanding audits and all outstanding IG recommendations, and get on top of how many of these were actually being ignored and report back to us within a month. They did that. I think we have given you copies of the reports.

We then set up a system within OMB that is no longer simply a check-the-box system. It is a system that says, we are not only going to examine these in depth as best we can with limited staff; we are going to determine which of them look like the highest priority risk items—this is risk for the future—I'll get to criminal in a second—systemic risks as identified. For each of these, we demand that a detailed plan for remedying material weaknesses be submitted within a very short period—I think it is two weeks—by the effected department.

Then, we and the department in question, jointly track what is being done to get rid of that material weakness in the areas we identify as high risk/high consequence. We cannot do it for everything at OMB, but we can try to pick out a selection and do it for the high risk ones. Most of the items, by the way, that the IG discussed with you, are on our high risk list now and being tracked.

Notice, in the case of criminal matters, we do not have the authority to investigate criminal matters. What I have done is change

the internal regulations and have now required that anyone who receives information of any kind that could be in the nature of a criminal lead from an IG, a GAO audit, a rumor, a lead in the budget examination process, by whatever means, they are obliged immediately to inform our own general counsel, who is in turn obliged immediately to refer the matter to the Justice Department for investigation.

So on the criminal part, we don't have authority. We can only work on systemic weaknesses. The criminal part, we have to refer to Justice and, of course, most of it is also in the hands of the IG's.

I think we have got a somewhat improved system. It will be a while before we can really judge it. But, I think if you talked to the IG's, they would tell you that looking at it from their perspective, the top management in their departments are now, in some cases for the first time, seriously engaged in looking at these audits and the IG recommendations, and working on plans for addressing the problems that are identified. Whether that will be sufficient to reduce a substantial portion of the problem or not remains to be seen. I can guarantee you, the old system was one that just did not have any teeth in it. It was good at the IG level, but at the policy levels not enough was done to follow-up. I think we have got a system that is going to be better able to address that.

Chairman GLENN. You referred to what happens if the IGs refer something to Justice, and that is a whole other subject I want to get into a little bit later, because Justice just recently cut back the authority of the IG's to do anything about these things. And that is a bigger concern yet.

Senator Roth?

Senator ROTH. Let me ask you this, Mr. Darman. Isn't part of the real problem that trying to correct the system is just impractical politically. We have a Goldberg contraption. We really have done nothing about reform of Government since the 1950's, and last year we did pass a Little Hoover Commission as part of the Veterans legislation, which gave the President an opportunity to create a new Hoover Commission. But the Administration was concerned that while we could create a new study, we didn't have any power to do anything about it. The concern was that it would just result in being another commission, another study to put on some shelf, but there was no ability on the part of the Administration to push action.

I think that was a legitimate complaint, frankly, because we all know that the minute you try to change the system, Congress is not supportive. You try to do anything about the agencies, consolidate in anyway, then you get in problems with the Committee. Isn't part of the real problem that nobody is really willing to use the political muscle that is necessary to reform because it costs too much politically when there are others that seem to be more critical problems at the moment?

Mr. DARMAN. Well, Senator Roth, I think that you are right that political considerations tend to interfere with what most reasonable people might think of as appropriate organizational structure, and that that undoubtedly contributes to part of the problem.

But it isn't just that, surely. Let me pick a real simple example. Really, I don't think it is the fault of politics, in the sense we nor-

mally might mean it here. If you say on any given day of the week there is a bill pending in the Congress—let's take the drug bill—we would like to look at all the unobligated balances and determine how we want to allocate the unobligated balances.

We don't have a rudimentary—I mean, we do have a rudimentary, but it is inadequate—financial system to tell us on anything remotely like a current basis where that stands.

Senator ROTH. Some of us, including GAO and others, have fought to create an accounting system, with chief financial officers, being one of the steps, but there isn't the political will to do it?

Mr. DARMAN. I think those things would help. I thought you were referring, when you referred to the legislation we didn't move on in the Hoover Commission, I thought you were referring also to the sort of reorganization of the departmental structures.

Senator ROTH. I think that is part of the problem. All we are doing is creating more agencies, but we never do anything about consolidating or looking at it from an efficiency point of view, either in the Executive Branch or here in the Congress. We talk about it but we never do anything.

Mr. DARMAN. We need though, I think, if you were asking me my highest priority personally, it would not be the restructuring of departments, however important that may be.

I think that it is probably more important and perhaps more easily doable to move forward on a few more major steps in basic financial systems, independently of the organizational structure.

We really need to get that done. It is ridiculous to imagine having a system that is going to involve serious accountability and even the ability to audit in some cases, if you don't have some of the basics of a centralized and detailed financial management system.

Senator ROTH. I have been in the Senate 18 years. We have been talking about a standard accounting procedure for 18 years, as long as I have been a member of this Committee.

Chairman GLENN. And we have 400.

Senator ROTH. And we have what? 400?

Chairman GLENN. That is what GAO said, 400 separate systems. They said 200 major different systems.

Senator ROTH. I am talking about chief financial officers now. I want to congratulate Jack Kemp and the President for putting a chief financial officer there at HUD. I think we wrote that into the legislation on the Veterans Department, but, you know, we talk about this. How can you audit records that don't exist?

Mr. DARMAN. That's right.

Senator ROTH. Whose responsibility is it within each of the agencies? How can we move now and get this job done?

Mr. DARMAN. We are trying to do it, but we have within OMB total commitment and tiny resources. We have asked for more resources to allocate to the oversight in this area, to give it a push. I think we have got the bureaucratic power to get it done but we haven't had the human resources. We are working on getting those out of the Appropriations process with the support of this Committee and the Chairman and you, I know, can appreciate that.

We'll have a start in that direction. I think it would be helpful also, as some of you have previously suggested, to have a Chief Fi-

nancial Officer for the Government as a whole within OMB, and to have that person of sufficiently high stature and with that single responsibility; so you could have a first class person in the field brought in from the outside with clout to have his job be nothing but the oversight of this.

If we cannot get that, we are still going to work on it. It would just be a little easier if we had that.

Senator ROTH. Well, I strongly support the creation of a chief financial officer. I don't have any preference where—I mean if it is in OMB, that is fine with me. I would just like to get it somewhere.

Mr. DARMAN. I don't have a strong view myself. I said earlier and I continue to feel that I don't have a strong view on the bureaucratic issue. There needs to be one. We feel it daily and I know that we would push very hard for further implementation in the direction I think you are interested in.

Senator ROTH. My time is up, thank you, Mr. Chairman.

Chairman GLENN. Thank you. Senator Levin?

Senator LEVIN. Thank you, Mr. Chairman.

Mr. Darman, the General Accounting Office has expressed a strong concern with the lack of program evaluation information in the Federal agencies. And in November of 1988 there was a transition report that was prepared by the GAO on program evaluation issues. Their findings were mighty disturbing.

I'll give you some examples. The quality of program evaluation information in the Defense Department they said on some defense programs is so low that findings are misleading. The Secretary of Defense and Congress regularly receive information that contains inaccuracies in the data, according to the GAO. They also receive assessments that consistently transmit a more favorable presentation of test adequacy and system performance than is warranted by the facts.

Other agencies have the same problem. GAO says EPA doesn't even know whether many multibillion dollar environmental programs are effective in achieving planned goals because its evaluation information is misleading.

It goes on and on. At the time of your confirmation, or shortly thereafter, I asked you about this. I also sent you a letter urging you to meet with the Controller General. I am told that a meeting took place and that you invited the Controller General to present specific recommendations. We have checked back with the Controller General and his office have said that they have been trying to meet with you, now, for months, without success, to go over their specific recommendations.

Why are they unable to get a meeting with you?

Mr. DARMAN. Well, they were able to get a meeting——

Senator LEVIN. No, I mean the follow-up meeting with the specific recommendations.

Mr. DARMAN. All I asked was that before the next meeting they be willing to send over some written material and then we would meet again, and I look forward to it, but the written material, I thought, would make the meeting more useful. The people who came over, the two people mainly involved, were Mr. Bowsher, whom I have known for 20 years, and Lois-ellen Dada, who is his chief person on this and who worked indirectly for me almost 20

years ago on program evaluation. And, while I have great respect for her, I think I understand her views since we used to work together.

I'll be happy to have more meetings but——

Senator LEVIN. Is the short answer that you have asked for written material that you have not received?

Mr. DARMAN. I don't think I have. Perhaps I have recently. In any case, I have no problem with the idea of meeting with them. Our preliminary discussion was not terribly—could I back up a step? This is a little bit arrogant, but this is the field I started in, program evaluation. That was where I started in this business, and it was my academic field, and I somewhat arrogantly feel, I know something about the field. I didn't feel I got a tremendous lot out of the meeting. I'll be happy to have some more if that would make you feel good, Senator, but I'm not sure that is going to solve our program evaluation problems in the Government.

Senator LEVIN. In other words, you don't expect the meeting to be particularly helpful?

Mr. DARMAN. Well, it may be. It remains to be seen. Meeting number one was to try to—I still don't know what I got out of meeting number one.

Senator LEVIN. Let me ask a different question about your own agency, then.

Mr. DARMAN. The subject is important, Senator, and may I make a couple of positive statements on the subject?

Senator LEVIN. Well, we only have 5 minutes. You are willing to meet with them again and you don't know if you have gotten the written materials or not. Is that the bottom line?

Mr. DARMAN. Correct. I'm certainly willing to meet with them again.

Senator LEVIN. In your own agency I understand that you have not yet appointed a permanent director of the Office of Federal Procurement Policy or a permanent director of the Office of Information and Regulatory Affairs. Those are two key management posts. When do you expect to make those nominations? It is now 9 months into the Bush Administration.

Mr. DARMAN. Well, of course, in the case of the Office of Information and Regulatory Affairs, we have had a permanent and confirmed person in office for the entire period. We do today, and his resignation was only announced at the time of his nomination to be a Federal judge, which is pending before the Senate.

In the case of OIRA, we are running into some difficulty in discussions we have had, in part because of the uncertain state of the OIRA's reauthorization. It is not the easiest thing in the world to talk about a job with someone when—not on the Senate side, but on the House side—they are trying to abolish the agency, at least temporarily, in the appropriations process.

Senator LEVIN. You are going to wait for that uncertainty to be removed, basically, on that?

Mr. DARMAN. On OIRA we are. In fact I don't think you can get a first class person for OIRA until the person understands what the legislative and legal environment they are going to operate in may be, to judge by conversations I have had.

In the case of OFPP, we have an acting director who is a career person and who is outstanding. And in such places I have preferred to stick with career people if I have been unable to identify a better outside political person. This is one such case.

Senator LEVIN. Before my time runs out let me just ask one unrelated question. I read your speech on "now now-ism" and I thought it was a very effective speech, a good speech, and I have a very specific question in carrying out your own themes in that speech, and that has to do with whether or not the Social Security trust funds should be used to help meet Gramm-Rudman targets.

Do you support the Hollings amendment which would separate the Social Security trust funds so we do not use them towards meeting the Gramm-Rudman targets, or do you support delaying that change?

Mr. DARMAN. I support delaying the change until 1993 or thereabouts, but I do support a change. We have not yet taken an explicit position on the form of the change. I can tell you, informally, that I'm inclined toward an accounting system that would keep Social Security part of the budget, the unified budget, but that would have the practical effect that is the same as that which is sought by Senators Gramm and Hollings, and perhaps you, I don't know, and others, to stop using the annual operating surplus or cash surplus that comes in for Social Security to cover the consolidated deficit, but starting in 1993. And, I have got a suggested way of handling the accounting that is different from theirs, but with the same effect.

Senator LEVIN. My time is up, but I would suggest to you that's an example of doing something later which we ought to do now.

Mr. DARMAN. Senator, could I respond on that? You are certainly right, it is doing something later which in a sense we ought to do now. It is a practical political problem. If we do it now——

Senator LEVIN. There always are——

Mr. DARMAN. Well, if we do it now, what is going to be the deficit target? The people who have suggested doing it now have just invented a dodge. They immediately adjust the Gramm-Rudman target upward to make up the difference. So it is, to a certain extent, a phony.

Senator LEVIN. Thank you.

Chairman GLENN. Senator Stevens?

Senator STEVENS. My friend was here ahead of me.

Chairman GLENN. All right. Senator Pryor?

Senator PRYOR. Mr. Chairman, Senator Lieberman was——

Chairman GLENN. I think all four of you were here when I kicked off the meeting. That is when we set our priorities here.

Senator PRYOR. Thank you, Mr. Chairman.

Mr. Darman, once again I'm back into the area of who is our Government, and I hope we can focus on that for a moment. We have here, for example, and I will once again address EPA, June 23, 1989, a request from EPA officials to another part of their agency to grant a sole source contract, or to extend a sole source contract to a contractor. And the reason is, "unusual and compelling urgency." This is EPA. The company is Sobotka. If an extension is not granted to Sobotka, here is what they say is going to happen, and I'm quoting from their request.

"One, bring to a halt the wastewater program enforcement's ability to report RCRA enforcement accomplishments through the strategic planning and management system to EPA senior management." This system is the main system used by the administrator to manage the agency, to oversee environmental programs in all 50 states and to record the agency's accomplishments. It also is an analysis made available to the Congress, to the Senate, to OMB, to GAO, and to the IG office. The development maintenance analysis which Sobotka is responsible for is a very complex undertaking.

In other words, the point, unless they grant this sole source extension to a contractor, who is located on M Street—the contract is for over a million dollars—the whole system of the EPA is going to fall apart.

Now, do you have a comment on that type of Government, this sort of reliance upon the private sector to manage the Government, to inform the Congress, and to run the various programs out in the states that they said would be diminished if this contractor was not rehired? Do you have a comment on that?

Mr. DARMAN. I don't know the specific case, but assuming, as I, of course, am happy to, that is exactly as you describe it, it sounds like a case where the function ought to be within Government. In other words, if there is a function absolutely vital to the continuing management of the Government and there isn't a reason rooted in interest in competition to have it performed more efficiently outside—which apparently there isn't since it is sole source—unless there is some special proprietary claim that the firm has, I would have thought the function should be within Government.

Senator PRYOR. This is what I think about Government, it is what I have always understood, but now to a large extent we have pretty well turned Government policy decisions over to the outside contracting world.

Now, I would like to go back, if I might, to SMS, the consulting firm, and BDM. Evidently they are combined. BDM is one of the major defense contractors. Once again, reading from their request for their services to be paid for or reinstated, they have stated that they have assisted in collecting and compiling integrated potential questions and answers for Admiral Watkins' confirmation hearings. Similarly, SMS assisted in preparing Mr. Wade's testimony for presentation before Senator Glenn and his Committee.

These are private contractors, these are defense contractors, these are the people who are in there getting all of these millions of dollars from the Defense Department budget, from the DOE budget and they are preparing the testimony.

I'm not going to ask a question of the press, but if they were at the National Press Club conference—I think it was back in December, or maybe it was in January—and if they heard a speech with any questions and answers by the Secretary of Energy who prepared the answers to the anticipated questions to be asked by the press to Secretary of Energy Watkins? SMS, BDM. It is right here, and they have stated that they prepared those answers to the anticipated questions.

Is that a role for private contractors? The answer is, no.

Now, I want to ask you, since you have been OMB Director, what have you done about all of this?

Mr. DARMAN. I don't know anything about those cases, so the answer is nothing.

Senator PRYOR. There are thousands like it.

Mr. DARMAN. Let me start with—

Senator PRYOR. But we are out of time, I'm afraid. I talked too long.

Chairman GLENN. Go ahead and respond.

Mr. DARMAN. I haven't done anything about that. I'm not even aware of that exact form of the problem. I write my own material. I would never tolerate an outside contractor having anything to do with writing questions and answers for me. I don't feel that that would be appropriate in my own particular case. Whether there is some specialized information that that contractor has, that only that contractor has, and whether the questions and answers relate—the questions related exactly to that in Admiral Watkins' case, I don't know. I assume he would have an appropriate explanation.

Senator PRYOR. Thank you.

Mr. DARMAN. When one is a private citizen, of course, as he was at the time he was being confirmed, then he can have private help of any type he would think appropriate.

Again, I personally don't favor that style, but that's a different matter.

Senator PRYOR. Thank you, Mr. Darman.

Chairman GLENN. Senator Stevens?

Senator STEVENS. Well, I'm not surprised at the situation that Senator Pryor mentions, Mr. Darman, because most of the money that Secretary Watkins is administering is grant money. We lost most of his people as they have left Government because of the pay situation. Now, this is not the time to get into the pay situation, but clearly, nonprofit corporations are managing a tremendous portion of the budget that you administer because of the pay situation that exists and the exodus of mid-level and near top level executives from the Government.

But what concerns me about this hearing is that the more I hear about meetings the more I wonder how much time you have to do your job if you are in all these meetings. I just got a memo to indicate the inspectors want the right to fine people, to arrest people, and to have subpoena power now to carry out their functions. Have not we created such a maze out there that no one is really getting around to providing service to the public?

Mr. DARMAN. Well, I don't think it is quite that bad, but I understand the problem you are referring to. I mean, obviously, very few people at the Federal level directly provide service to anybody. It is ultimately at the local level. A lot of people here like to believe that they are being of service. The actual service is delivered somewhere else, generally. And you are right, we spend a ridiculous amount of time in meetings.

Senator STEVENS. Well, I'm not being facetious. Some of us terminated OEO because we found out the beneficiaries of OEO were getting less than 20 percent of the total cost of OEO. Aren't we getting to the same point now with these redundant examinations of agencies such as the Forest Service and Interior, and to a certain extent the DOD procurement?

Mr. DARMAN. I understand your concern, but there is a tiny percentage of the budget that is actually spent on investigative oversight. In fact, I would expect we are going to increase it a little bit.

Senator STEVENS. It is not the percentage of the budget, it is the delay at the top. Those people who are subject to these redundant examinations are not completing the paperwork that enables the people out in my area to do the job that Congress thinks they are going to do, because they just don't have the time to process the project approvals. Particularly, go in the Corps of Engineers sometime and look at the delay now between authorization of the money, availability of the money to carry out projects, and the actual initiation because of the redundant examinations each one of those projects goes through.

Now, are you doing anything about that? I know my friends here are interested in more Inspectors General and more investigations. I see from the wall examples of them. But I'm interested in trying to see if someone would ever complete dams and complete projects out in the harbors and find ways to initiate some of the projects that we thought we had authorized.

Mr. DARMAN. Well, I'm interested in both, Senator. In the case of the investigations that have been done, not new ones, it would be nice if the product of those investigations were itself acted upon. And so, part of what we are doing in the meetings I was referring to, is trying to assure that the investigative work that does correctly expose some problems, that it is acted upon. It is the worst of both worlds if you got the delay in order to assure appropriate capacity for oversight and then you don't exercise the appropriate oversight. Then you have got the worst of both worlds.

On the question of how much delay for the purpose of having the oversight, it is a difficult balancing problem. You have a complex, decentralized, giant system and the most streamlined version of it will have in many respects too little accountability. The more you build in accountability in this layered, decentralized system, the more complicated you make it, and that has pluses and minuses. It makes it harder to deliver services sometimes and sometimes harder to assure accountability. But, on the other hand, sometimes it is essential in order to be able to have a chance at accountability. I don't think there is a general answer.

Take the simple model, we got a one \$1.2 trillion budget. The simplest model would have no one in between and we would just have a formula redistribution to everybody and let them figure out collectively at the local level how they wanted to get everything done. Obviously, that isn't going to work. So we are going to have some variant in the in-between land. And, once we have a variant in the in-between land, there is going to be some form of administrative delay that derives from the complexity of the system.

Senator STEVENS. Well, I don't want to go into it now, but I do think that the Paperwork Reduction Act has been abandoned. I think that the whole concept of looking at the redundancy of these investigations, examinations, inspections has not been examined. We need to look at what the total product really ought to be for Government, and that is to provide the service that we say we are supposed to provide. And I am concerned about some of the demands I am hearing for increased resources for the Inspectors Gen-

eral before the original goals that we set for them are accomplished.

Thank you, Mr. Chairman.

Chairman GLENN. Thank you. Senator Kohl I believe was here when we opened, and then we will go to Senator Sasser and Senator Lieberman.

Senator KOHL. Thank you, Chairman Glenn.

Mr. Darman, good management is not possible without an honest and accurate outlook on the budget picture. I don't believe we can do effective long term planning on the management side of our Government if we don't first know what resources will be available to us. And so in connection with that I would like to ask you some questions.

Mr. Darman, shortly after the President assumed office he submitted a budget, you recall, that was very long on promise but certainly very short on detail and, as you know, that lack of detail delayed budget negotiation for weeks.

My question, Mr. Darman, is this. This year will you provide Congress with a detailed budget submission that includes the line by line detail of earlier years' budget appendices?

Mr. DARMAN. The answer is yes, Senator Kohl. And I would add—and be more than fully prepared to defend for the record and in any other way—that we submitted more detail, in a more timely manner as an incoming Administration than any Administration ever.

Senator KOHL. But that line by line detail will be submitted?

Mr. DARMAN. Yes, sir, it will be submitted.

Senator KOHL. Thank you.

Mr. DARMAN. I have never, ever, suggested otherwise, and the last time more was submitted than had ever been submitted before.

Senator KOHL. Mr. Darman, the other day you made an excellent speech and whatever else in life you may accomplish, and I'm sure it will be considerable, you will always be remembered for contributing "now now-ism" to the English lexicon.

At any rate, I thought your speech, Mr. Darman, was very much on target, but I would like to ask the question whether or not we are to do as you say or as you do. I'm referring to an article, for the moment, written by Charles Krauthammer in the Washington Post the other day. And as you know, the article points to the inconsistency of an Administration that says on the one hand it is concerned about the long run while at the same time supporting a capital gains tax break like the one passed by the House.

And the question I would like to ask you is how you reconcile your concern for the long run with the 2 year capital gains tax proposal?

Mr. DARMAN. Well, the interest in the long run and the interest in an incentive for long term investment, such as a capital gains incentive, correctly designed, are completely consistent with each other, in my view.

The narrower question should be, but how about the House proposal? And in the case of the specific House proposal, it was flawed. I said so at the time and said that I hoped we would improve it on the Senate side. It was not the President's proposal, which I think is better designed. I think the proposal that lost 10-10 in the Fi-

nance Committee is better designed. I think that there are others that are being talked about on the Senate side that are better designed proposals to assure long term investment.

That particular proposal had an indexing feature which was permanent which is of some value, but doesn't really address the long term incentive for investment. It addresses a different issue, whether you should attack inflation, and it marginally lowers the cost of capital, which is a good thing.

But the 2-two year window is an inappropriate construct. It was the best available legislatively at the time and we said, as we have done many times—indeed, as we did with tax reform itself—let's pass it through the House in an imperfect form and improve it in the Senate.

Senator KOHL. Are you saying that if the Senate adopts the same proposal as the House the President will veto it?

Mr. DARMAN. No. I think that that proposal is better than none at all because we can extend it.

Senator KOHL. Is it really? What are you, or we, or us, saying to the investors of this country?

Mr. DARMAN. The investors don't believe what we would be saying if we were to tell them we have got a let's say 50-year exclusion, because they have had a new tax bill almost every year for each of the years in the 1980's.

What they will look at is whether the political system is sort of looking like it cares more about investment for the long term these days or not. And, I think that if we did a 2-year one—I think we should do better than that—but if we did a two-year one, I think they would conclude, yes, the political system looks like it is tilted towards an interest in treating longer term gains preferentially.

Senator KOHL. What do we tell the country when we shift from one year to the next? In 1986 we told the country—and it was the Administration of which Mr. Bush was a part—that the tax reform bill of 1986 made sense. That was the philosophy, we adopted it, we supported it, we didn't want any short term fixes, we wanted a long term investment philosophy. And 2 years later we turn around and tell the country something entirely different.

Now, do we become irrelevant? I mean, what are we saying? How do we reconcile what we told the country in 1986 with what we are doing in 1988?

Mr. DARMAN. Senator, I'm sorry to report to you—you weren't here at the time so you can claim innocence—I was here at the time of the tax reform of 1986, at which time, I believe we included, certainly in the House version, language which said we wouldn't change the tax code for five more years.

Within 30 seconds, the technical corrections act, "technical corrections act," which was the second largest tax bill in history, was moved through the House. It took a year or so, or perhaps more, to get it actually enacted, but if you want to talk about hypocrisy, I mean there was one of the most extreme examples you could find. It was not as if this is the first instance, here coming up with the reconciliation now. It was within 30 seconds of the action in the House, about a 700 to 800 page tax bill was introduced with so-called technical corrections.

Now, I mean, that is a complicated subject, how our political system works. May I speak to a narrower or a different but related point? You could ask this question. Does, as some have suggested, capital gains as we are suggesting—an incentive for long term investment—does that in any way violate tax reform as it was understood by the participants at the time?

In my opinion, it is worth noting when the House passed tax reform it preserved a capital gains incentive. When Chairman Rostenkowski went on national television and said "Write Rosty" it was for a bill that preserved the capital gains incentive.

So if it was crucial to tax reform at that time, it was not in the bill. It came in on the Senate side. But the crucial things that came in on the Senate side were the establishment of an alternative minimum tax and the much lower rates, themselves a reform measure, the leveling of the playing field with respect to business investment, and the passive loss rule. Those are the key elements of reform, and there is nothing in creating an incentive for long term investment that in any way violates those four key tenets, nothing.

Senator KOHL. My time is finished, but I just offer the final observation that the bill that was passed by the House is about as far away as you can get from encouraging long term investment, in my opinion.

Chairman GLENN. We are going to have to break for about 20 minutes. We have three back-to-back votes on the floor and we are down to less than half our time now on the first vote, so we are going to have to break for about 20 minutes. The second two votes are 10 minutes each, so we will get back just as fast as we can.

I'm sorry to have to do this, but duty calls.

[Brief recess]

Chairman GLENN. The hearing will resume, at least for a little while. We are still on votes over there and I'm sorry for this truncated hearing, but it is beyond my control. So we will run as long as we can, consistent with what other votes are called for.

I would like to ask, Mr. Darman, about what you know about and what your views are of the recent Justice Department's Office of Legal Counsel opinion concerning the scope of an IG's investigative authority. It has caused the IGs either to stop doing certain kinds of cases, or put a monstrous legal cloud over their ongoing work.

And let me indicate just what has occurred on this. Just in the Labor Department the IG, as a result of this, has suspended a total of somewhere around 1,200 cases that are now on hold. This involves 993 cases in Unemployment Insurance fraud, Wage and Hour Program fraud, Black Lung Program fraud, Longshoremen and Harbor Workers Program fraud, OFCCP Program fraud, Mine Safety and Health fraud, OSHA fraud, Employee Benefit Plan fraud, Alien Certification Program fraud.

This is 1,200 and some cases. I would ask first if the Secretary of Labor has contacted you about this or if the President and you have concern about this, and what we are going to do about it, because this really is hamstringing the IGs right now and I don't blame them for holding up, in light of this situation.

But as I said in my opening statement, when we are right in the middle of all this, the IGs are doing a great job, really pinpointing

some things that have needed pinpointing for a long time, and then I suppose it was all just circumstance that the Attorney General comes out with something that limits their authority. You must admit we have a right to be a little bit suspicious until we get some answers up here.

Have you looked at this situation? We have 1,200 cases now being held up on this, just in one department, it doesn't cover the other IG's.

Mr. DARMAN. Yes, Mr. Chairman, I'm well aware of the case and a certain amount of time has been spent on it. We are trying very hard, OMB itself, and you know Frank Hodsoll, Executive Associate Director for Management, who is here today, and he has been working with the Inspectors General, the Justice Department and the White House Counsel's Office to try to see if we can come up with a kind of compromise rather quickly that resolves the uncertainty in a way that is satisfactory to the various parties.

It was important initially to clarify something which I think now has been clarified in the minds of IG's, which is that the Justice Department opinion applied directly only to the Department of Labor. I know that is still a problem from your perspective, but from their perspective they interpreted it initially as a general ruling. It has now been clarified. It is a ruling that applies not only to Justice's interpretation of the IG statute, but other statutory provisions that relate to Labor.

Justice has now made it clear, not only in writing but in personal conversations, as I understand it, with the other IG's that the interpretation with respect to Labor does not automatically apply to the others.

The question is what does apply to the others? This is being sorted out quickly so that we don't have things on hold because of this uncertainty. It seems to me you had here a number of different kinds of problems, only one or two of which are legitimate. You had a little bit of a turf dispute within Labor in the first instance. As you know, Justice really got into the act only because of a turf dispute within Labor that wasn't satisfactorily resolved internally. Justice got in and sort of maybe accidentally over corrected, and got the rest of the IG community all disturbed.

Now I think we have got that back in the mode where people are trying to sort it through on the merits. The issues on the merits involve the various statutes that apply, not just the IG statutes and looking at those on the merits department by department. And then there is a residual issue in the gray area that involves a sort of judgment about constitutional separation of powers issues and who should have responsibility for oversight of some of these functions.

I hope we don't end up with too much of the very last kind of issue, because then the Congress and the Executive Branch become at odds. I hope we are going to be able to sort this through quickly in a way that you will find at least a reasonable interpretation of the law and a workable basis for everybody to proceed.

Nobody is saying the investigations should not be done, as I understand it. It is a question of whether they are done under one kind of departmental authority, another kind, or Justice's authority.

Chairman GLENN. Well, they made a rather narrow interpretation, from our standpoint, that this only applied in cases where you were directing the investigation at specific Federal employees or where Federal dollars were involved. This would mean it would take them completely out of anything where they were overseeing regulatory programs or other things that we think are important, too, and which is in the law.

Mr. DARMAN. Yes. I'm not really legally qualified to make a judgment on this, and I really ought not to even venture one, but as an amateur observer it seemed to me that with a little creativity that limitation wouldn't turn out to be that much of a limitation anyhow, because if the required entry point is the involvement of a Federal worker in some way or other as might relate not necessarily to criminal action but just failure to address the management responsibility, efficiency, and so on, it seems to me you would still have a very wide scope for IG involvement.

Chairman GLENN. I agree with that except if you are an IG and you have people who are very loyal to you and they are oftentimes criticized by people within the department that they are looking into and they feel like a beleaguered group half the time, and they know very good and well if they overstep the bounds as far as the law, overstep the law a little bit, they are probably going to have a suit filed against them. And if the Attorney General comes out and says that it is his opinion that they are going too far in these areas, then they say a suit can be filed against them, they are going to pull their horns in. And so their investigations become less than they should be. That is the problem.

I saw it from the IG's standpoint, I saw what their problem was on this. I agree with you, though, that they probably still have authority if they wish to take that chance on whether there would be suits filed against them. But they shouldn't be required to do that.

Mr. DARMAN. I emphasize that mine was just an amateur opinion, though. I guarantee that there are people who would strongly differ with what I just said.

Chairman GLENN. Who is working on resolving this issue now?

Mr. DARMAN. From OMB's standpoint, our General Counsel and Frank Hodsoll are the two lead people. In the White House it is the Counsel's Office, Boyden Gray. And Sherman Funk, I think, has the lead among the IG's, and I'm not sure who does at Justice; well, Bill Barr, Assistant Attorney General, Bill Barr.

Chairman GLENN. With the IG's reporting directions, to the Administration and to Congress, I think we probably should be consulted some on this also as to what our opinions are up here.

Mr. DARMAN. We would be happy to do that, Senator.

Chairman GLENN. I think once you have worked this out, then before we decide what the final ruling is going to be out at Justice that we should probably be apprised of what this is to make sure it is satisfactory from our standpoint, too. I don't want to get into a continual wrangle on this subject.

Mr. DARMAN. No, we don't either. I think it is very desirable that we not get into an extended argument. I only learned about it relatively recently, but we are trying to resolve it quickly.

Chairman GLENN. Nominees to the IG's, with all the importance we are attaching to the IG's, you had in your longer statement a

short rundown of the IG nominations' status here. Here we are 8½ months into this Administration. Why haven't, of all people, the IG's been put into place?

Mr. DARMAN. Well, I think it is a bit of a failure on our part, benign in intent. It derives in part from the fact that there was a decision made early on, which was a positive decision, which was that the IG's should not automatically be removed. And, once it was decided that the IG's should stay in place until a judgment was made case by case as to whether the particular person was the best, once that threshold was crossed, I'm afraid you had kind of a bureaucratic relaxation on the subject. People sort of mentally, especially, I would think, in the White House Office of Personnel where they have got 15 zillion other appointments, started thinking, well, those are under control for the time being, let's work on something else.

So we didn't move as quickly as we should have. We started paying attention to it within OMB and putting some pressure on it. I think that the record would show that our effort to get it moving is what helps account for such progress as has been made. We are now in a position where we are trying to explain a problem that is largely resolved. Why was there a delay—at least most of the positions are now settled.

Chairman GLENN. Well, we still do not have IG's appointed at Justice, Treasury, FEMA, VA, OPM. Those are all vacant. Those are some very important agencies there.

When can we expect those nominations to come up to us?

Mr. DARMAN. We don't unilaterally determine this at OMB, is the problem, as you know. I said the same thing at the time of my confirmation hearings, that when it came to appointments—I don't mean to be ducking—the reality is we do not unilaterally control that process. I can give you a guesstimate, but it is not within our control. The review process is shared—just one second—we can't give you a responsible guess on how fast.

Chairman GLENN. Would you go back and consult whoever needs to be consulted and let us know when we can expect nominations?

Mr. DARMAN. Yes, sir.

Chairman GLENN. We are approaching a year into this Administration, or will be in another 3 months, and we don't even have the IGs in place yet.

Mr. DARMAN. Well, we can give you an answer, but there is a history of somewhat unreliable answers on this subject.

Chairman GLENN. You have indicated that there is already some sort of tacit understanding, at least, about the IGs having authority to go ahead beyond the narrow interpretation that was put on the Justice ruling; is that correct, or did I misread that?

Mr. DARMAN. No. All that I understand to be agreed—Frank may want to correct me on this—all that I understand to be agreed is that the ruling applies directly only to Labor. And beyond that, I was giving you my amateur view, not the considered Justice Department view.

Chairman GLENN. Let me get back to the nomination process. When the new Administration came in you indicated they weren't fired so they were still on the spot.

Were they told that, that they were specifically still in as full charge as they had ever been unless they were specifically asked to retire? Because in some of our discussions with the IG's they felt that with the new Administration and everything, it was sort of a "never, never land," they didn't really know whether they were continuing, nobody had ever told them this. They assumed that maybe they would be asked to go. They were less driving toward their goals within their departments than they might otherwise have been.

Were they told they were going to stay on?

Mr. DARMAN. It is my impression that they were told what was in fact the case, that they were told something that amounts to the absence of a negative, but that is not enough to relieve the uncertainty you are talking about. In other words, they were told, we are not starting with the presumption you must be removed. They were not told——

Chairman GLENN. That they would stay.

Mr. DARMAN [continuing]. Assume you have it forever. They were told it would be subject to case-by-case review, I think, which left them in a state of some uncertainty.

Chairman GLENN. I think that's the understatement of the week from our discussions with the IGs. They didn't know whether they were staying or not, so they didn't know what they were authorized to do.

Mr. DARMAN. That happens to be what I said. Not what you said. I mean the note I just received.

Chairman GLENN. Nothing I want to do less than break this hearing again, but we are on five lights, and I came back hoping that maybe this next vote was not going to occur for awhile. It has occurred, and so I have to go to the floor again and we will have to recess temporarily again.

Mr. DARMAN. That's fine, Mr. Chairman.

Chairman GLENN. I'm sorry about that.

[Brief recess.]

Senator SASSER. [Presiding.] The Committee will come to order.

Senator Glenn is still involved in voting on the floor and he asked me to go ahead and reconvene the Committee, as a convenience to the witness, to try to get Mr. Darman in and out of here as quickly as we can.

I am going to diverge here for just a moment from the central subject that is before us, although I think my questions will deal with the issue of what is good management in Government. Everybody I think here knows that this Government is operating under the shadow of sequester.

And I would submit to you, Mr. Darman, as the Director of the Office of Management and Budget, that there aren't too many worse examples of poor management than for sequester to take place, and for sequester to take place really for no reason at all. I think that indicates a failed leadership.

A sequester creates a chaos, I believe, that destroys confidence in Government, and it destroys confidence in those who are responsible for running Government. And that responsibility falls very heavily on the Office of the Director of the Office of Management and Budget. It falls very heavily on this Committee, which has the

responsibility for Government affairs. We used to call it the Government Operations Committee.

Now, I don't think we need to be facing sequester at all. I don't think we need to be facing this chaos. And I have said repeatedly that the capital gains issue has turned the budget reconciliation bill into a vehicle for everything but deficit reduction, which is what it is supposed to be. It has opened the flood gates to all kinds of extraneous provisions that both you, Mr. Darman, and I would rather see debated on some other bill other than a reconciliation bill. And I believe that but for capital gains we would have moved forward very quickly with a reconciliation bill that would have fully complied with the agreement that you and I and Chairman Panetta and then Majority Leader Foley and Senator Domenici and others worked on so long and so hard this spring. We gave up many hours working on that agreement.

Now, this morning I read with chagrin in the Wall Street Journal that you, Mr. Darman, actually had an opportunity to eliminate all of the extraneous and contentious debates from the reconciliation bill, along with the capital gains debate. And this was a proposal, according to the Wall Street Journal, that was supported by both the Speaker of the House of Representatives, Mr. Foley, and Mr. Michel, the Minority Leader of the House, a bipartisan agreement over there that would have stripped off these extraneous provisions and in return for that, Mr. Foley was to give Mr. Michel an up or down vote on the question of capital gains.

In other words, let capital gains stand alone and let's deal with the business at hand of deficit reduction and making this Government run in an orderly way. That is what the Speaker of the House of Representatives and the Minority Leader had in mind.

Now, they wanted to fulfill their budgetary responsibilities, but judging from the tenor of this article, it is expressly stated that you, Mr. Darman, and Mr. Sununu, speaking for the Administration, torpedoed the deal.

Now, if that isn't an example of Kamakazi management, I don't know what is. It looks to me as if relations with the Congress were sacrificed in the interest of capital gains, that the long term budgetary interests of the country took a back seat to winning a political victory on what I believe to be an extraneous matter on the reconciliation bill, and that is capital gains.

Now, I think we could call that budgetary "now now-ism," but you have heard what I have to say about that, Mr. Darman.

What do you say about this report that appeared this morning?

Mr. DARMAN. Senator Sasser, I take the liberty of referring to you in this room as Mr. Chairman, having the privilege of appearing before you in your capacity also as the Chairman of the Budget Committee, and say it is nice to see you. I am sorry for your question. I have got the article in front of me. I cannot claim to have read it in its entirety, so let me try to respond without having done so. And in doing so, I am sure there probably is material in here that I ought to rebut but that I won't rebut because I haven't read it, but I can answer your question.

First of all, I agree with you about sequester. I think sequester will be a sign of our collective failure to do what we should have

done, if we get to that. I do not believe we have to get to sequester, although the hour is late.

Senator SASSER. Nor do I.

Mr. DARMAN. I do believe that the Senate is now moving on a number of these issues and there is still the possibility of having a conference in the course of next week and that we should try to complete that and avoid sequester, for all of the reasons you referred to and others as well.

Second, on the point about capital gains and that being the cause of so many extraneous provisions in reconciliation, I would respectfully differ with you on that subject by noting that on the House side there was a host of what you would call, and I would call, extraneous provisions included in reconciliation in the reports from the various Committees, way before the Ways and Means Committee even acted. The same, I may say, is true on the Senate side. You have available the list of several hundred, at least, Byrd rule extraneous matters that have arisen in other contexts, not in the Senate Finance Committee.

Senator SASSER. Well, let me just ask you this, Mr. Darman, and shorten it. Would you agree with me that there is merit in stripping off the extraneous material, including capital gains, and moving quickly to a clean reconciliation bill?

Mr. DARMAN. No, and I would like to say why. A couple of points about that. You referred to our agreement, and you will recall that in the course of all our deliberations we asked only that we get a fair shot at the President's proposals. Some wanted to rule out the consideration of capital gains. We initially would like to have ruled it in. And what we agreed was that it would not be ruled out or in, but that there would be some opportunity for a fair judgment by the Congress on the merits. That's all we have ever asked for. It so happens that in the vote on the House side the judgment came out in favor of a capital gains provision.

Senator SASSER. But on a reconciliation bill?

Mr. DARMAN. There is absolutely nothing wrong with that. We indicated from day one that we intended to try to get capital gains in the context of reconciliation, and others said, we will oppose it. And we said fine, we will live by the judgment. The issue was, well, if it fails are there any other ways to achieve the \$5.3 billion revenue target, and I believe Chairman Rostenkowski and Senator Bentzen were persuaded that there were such ways, and indeed the record has now shown that there are such ways.

The point I wanted to get to, in terms of the House offer you refer to, is this. That very generous offer arose after it became clear to the House leadership that they were likely not to win on catastrophic health insurance, they were likely to lose—I think by the time the offer came they had already lost—on Section 89 repeal. They were likely to lose on the pension provisions—they did lose on the pension provisions—and they were likely to lose on capital gains.

So their generous offer was that on all of the issues where we had the votes, we should treat those as extraneous and separate them out. And on the issues—

Senator SASSER. But Michel agreed with that, didn't he.

Mr. DARMAN. I read that—in the part I did read here, it seems to suggest that in the article. I told Mr. Murray before he wrote the article—but apparently he didn't give too much weight to what I said—that as represented to us, Leader Michel, who did present us with the option, did not say that he supported or rejected it. He asked us what was our view. And our view was at that late hour where it was clear that we either had already won several of these votes or had the votes for the remaining ones, that at that late hour, an offer to take all of the things that we would win on and treat them as extraneous just in order to remove the remainder, which we had never particularly wanted, that that was not an offer that we should take.

We were not taking the position on grounds that have to do with whether we should be trying to force sequester or not force sequester. We do not want sequester any more than you do, Senator, and I believe, if I may say, that—just to repeat where we began—we are still going to get a chance to sort this all out in the conference, I hope.

Senator SASSER. Well, let he ask you this. The Joint Tax Committee estimates that the Jenkins proposal over in the House is a \$21 billion loser over this decade, and yet you are supporting it. Just let me ask you directly, what is your order of priorities? Which is more important, capital gains or moving forward forthrightly with regard to our fiscal responsibilities?

Capital gains is another issue that we can talk about later, and the Administration is entitled for that to be debated and introduced.

Mr. DARMAN. Well, Senator, we were asked—if I may say, privately, this is not an official offer for anybody—but we were asked on the Senate side, starting with the premise you start with—which I do not grant—that capital gains loses money over the 10 year period. But starting with that, on the grounds that according to the Joint Committee it loses money, shouldn't we pull out capital gains?

We responded. Well if that is the test, shouldn't we also pull out the IRA provision, which happens to lose twice as much money, at a minimum, according to the Joint Committee. Shouldn't we pull out of it if that is the test? And by the way, there are approximately 75 other provisions which would have to come out if that is the test. And the answer was no, just capital gains should come out.

Senator SASSER. Well, you and I both know that there would be no IRA provision were it not for capital gains—

Mr. DARMAN. If that's the case, why doesn't it disappear?

Senator SASSER [continuing]. And the Chairman of the Finance Committee has gone forward and paid for IRA's—

Mr. DARMAN. And capital gains come in for the out years. The bill from the House, there is no one who disputes—the Joint Committee says it fully meets a stiffer reconciliation target than the Senate's. The Senate's is only, as you know, a 1-year target to Senate Finance, and what it produces is a declining path, as purported by Senator Bentsen. On the House side, they meet the 2-year reconciliation target and produce more net revenue.

Senator SASSER. Well, we just have to go by what the Joint Tax Committee and CBO says here.

Mr. DARMAN. That's what they say, sir.

Senator SASSER. Well, they tell me, as I read it, it is a \$21 billion loser over the decade.

Now, one final question, because my time is expiring. The staffs of the House and Senate Budget Committees have been trying to secure from OMB cost estimates on pending legislation so we can know where we are with regard to sequester.

Now, I wrote you yesterday, along with Senator Domenici and our counterparts on the House side, asking for OMB's numbers so we could determine where we are with regard to triggering sequester. Now, it is unprecedented, I am told, for those numbers to be withheld from us.

Mr. DARMAN. I know of no intention whatsoever to withhold them. We provided them yesterday when asked on the House side. I did not know we had been requested by you. You could have them today.

Senator SASSER. All right. You can get them here today?

Mr. DARMAN. For sure. But please let me assure you, I knew of no such request. It has been my expectation. In fact, I have been surprised we didn't get the request sooner. I have been pleased, but surprised.

Senator SASSER. Thank you, Mr. Chairman.

Chairman GLENN. Thank you. Senator Lieberman?

Senator LIEBERMAN. Thank you, Mr. Chairman.

I have an opening statement that I will not read but ask to have it inserted into the record at this point.

[Senator Lieberman's opening statement follows:]

OPENING STATEMENT OF SENATOR LIEBERMAN

Mr. Chairman, thank you for holding this important hearing on OMB's management role. When Mr. Darman testified at his confirmation hearings in January, I had just begun as a new Senator. I asked only a handful of questions of Mr. Darman, one of which focused on improving OMB's management capabilities.

Only a few months have passed since that time, but a lot has happened. I have had to vote on a S&L bailout bill with a price tag of \$100 billion. I have heard compelling testimony in hearings before this Committee about the billions of dollars needed to clean up DOE's nuclear weapons facilities, to make them safe. I have listened as an incredible tale of mismanagement and corruption at HUD, costing the taxpayer untold millions, has unfolded in House subcommittee hearings. Recently, I have read about charges that FHA may be billions of dollars in the hole as a result of mismanagement of its lending programs.

Few could question that our government faces serious management problems. I do not mean to suggest that OMB is to blame for these problems, or that it alone could cure them. But OMB is at the pinnacle of executive power, and it has the authority to help improve the efficiency and effectiveness of the government. I am anxious to hear Mr. Darman's plans to improve OMB's performance in this regard.

I am also disturbed by the way in which OMB has wielded its awesome power to review agency regulations. Over the past eight years, OMB has used its review authority under the Paperwork Reduction Act and executive orders to stifle regulation—notably environmental and safety regulation—apparently on political grounds. For example, the lives of many Americans were jeopardized due to OMB's years of delaying EPA's efforts to prohibit asbestos and FDA's efforts to require labelling concerning Reye's syndrome on children's aspirin. Because of such abuses, the legislation to reauthorize the Paperwork Reduction Act, which is before this Committee, includes restrictions on OMB's regulatory review process.

It is difficult to escape the feeling that OMB ought to concentrate less on being the government's regulatory "thought police" and more on being the government's watchdog on efficiency and proper management. I look forward to hearing Mr. Darman's views on how to advance both of these goals.

Senator LIEBERMAN. Mr. Darman, it is now good afternoon, not good morning.

I want to pick up some of the earlier questioning from Chairman Glenn and others about the "M," or management function of OMB. I think we all agree that there are management problems in the Federal Government. In your statement I think you said quite clearly, management problems of the Federal Government are enormous. The most visible signs recently have been the scandals at HUD, and now FHA and the S&L bailout, but they all reflect an underlying problem and a critical need for tough management.

We talked about this at your confirmation hearing in January, and I appreciate your good faith in trying to improve management.

Let me ask you this. After 9 months, what percentage of your time would you say has been devoted to the management as opposed to the budgeting function of OMB?

Mr. DARMAN. Senator, I cannot give you an exact answer. Let me try this, because we have a definitional problem on management. If we were to define management as the subject matter that I was to testify on here today and to then judge it further by the questions I have been asked, 100 percent.

Senator LIEBERMAN. But a lot of those, such as the preceding dialogue, really sound budgetary, don't they?

Mr. DARMAN. They did sound a little that way to me.

Senator LIEBERMAN. Leaving aside the various dialogues of this morning and early afternoon, how would you describe or define the two functions? What is the budget function and what is the management function and how has your time been divided?

Mr. DARMAN. Maybe a better way to do it would be to look at it this way, and try to be fairly direct in responding. I don't think it is going to be productive to try to come up with an abstract definition. Let's talk about kinds of things, particular regulatory problems that are under review that require some mediation, involvement, judgment through OIRA and my relationship with OIRA.

I would call that clearly part of management. Related matters under the Paperwork Reduction Act, issues related to the organization of Government. The management by objectives system that we have tried to get up and running and now do have up and running. The introduction of longer range analyses of investment issues, the review of such analyses—and they have been developed in-house—their integration with the next budget. The reformulation of the next budget to try to look more at investment issues, as I said I would in my original confirmation hearings.

If I were to include, say, those, as a sample of management issues, I don't know, I would roughly guess that those might take—just roughly, I don't know—30 percent. I'm not at all sure of that, that's off the top of the head.

Senator LIEBERMAN. Right, understood. I'm asking for an impression of it.

Here is my concern, I have watched the 9 months, obviously you have been central to a lot of important decisions that have been made here in the Congress and certainly in the Executive Branch. And I understand the logic that initially drew the management and budgeting functions OMB together. My concern is that, despite the critical importance of the management function, it seems inevi-

table that management will always be the tail on the dog and not the dog. Management is so critical that it really has to be the dog. So just to state the question in its extreme, wouldn't it make more sense to separate out the management function and create a separate management agency?

Mr. DARMAN. I don't think so, Senator, although I have been in so many departments and agencies that you have to believe that I don't care about bureaucratic turf issues. There is a perfectly good chance that I will land in the next agency, so that is not the issue with me. But let me explain why I think that it ought not to be separated out and what I think should be done instead.

The reason I think it ought not to be separated out is for better or for worse there is power where the money is.

Senator LIEBERMAN. Right.

Mr. DARMAN. And if you really want something done under management heading, or as it happens, almost any other heading that is floating around, it tends to end up coming back to OMB sooner or later, because so many of these issues, especially in these times, are resource constrained, or involve resources in an important way.

And so if they are linked, you have got a much better chance of implementing the things you are interested in with respect to management. That would be point one.

I would predict that if you had a free-floating management operation you would have flurries here and there of reports and activity and so on and not a heck of a lot done. Not necessarily true, but that would be the odds on outcome.

If you have them linked, you have at least got a link with power. Now, I think there is also an intellectual link. If you look at those issues that are up there, and many of these over here—I can't read every one of those quickly—but a quick look, almost every one of them is absolutely intertwined with the budget issues. And our real problem, is, I think, getting the "M" to have sufficient attention in the treatment of all of these budget related issues. The place to do that I think is in an integrated OMB with a much stronger "M."

I hate to say this, but let me point to what is an embarrassingly absurd situation. I'm pleased to say I do not believe I am wholly responsible for it, but I happen to be located where this is manifest. We have "M" for management for the whole Government. How many people do we have for this one \$1.2 trillion Government? About 30 professionals. That's about \$40 billion per person for management oversight.

Senator LIEBERMAN. It's impossible.

Mr. DARMAN. I mean, that is an utter absurdity. Now, we have, I think correctly, requested a modest increase in the allocation of people to the job. That is a precondition for doing this job right. We have got people who work minimum 80 hours a week at OMB. You can come any Saturday or Sunday, you can come till midnight—of course, I know you are here also sometimes till midnight or later—and you will find these same hard working, overworked people, career people, trying to do a job which, when you think of it that way, \$40 billion dollars a head for management oversight is ridiculous.

Now, that is obviously not a correct calculation, but it is sort of indicative. The allocation of resources to the task simply hasn't been there.

Senator LIEBERMAN. I agree. You know, I accept your basic premise that your budgetary clout enables you to control resources, personnel, budget expenditures, and even regulations, and gives you the ability to force people to make management decisions they wouldn't otherwise make. But the dilemma is that, inevitably, the director of this office is going to be pulled into the more topical, more compelling day-to-day budgetary questions. How can we structure this office so that you are just as focused on the management end, and frankly, how can we help you get more than the 30 people?

I urge you to use all of your skill and intelligence, which you have amply demonstrated, to be bold in trying to expand this part of your job, because management issues underlie all the topical problems of the day.

Mr. DARMAN. Could I take just a little bit of time, Mr. Chairman, and say something about that.

Senator, when I was testifying at the time of confirmation, I said that I thought there ought to be more resources allocated to management, but I also said that I wasn't going to ask for them, or at least I thought I wasn't going to ask for them, I didn't make an absolute commitment.

I said I thought I wasn't going to ask for them because in this period of tight budgets and so on it would be viewed as hypocritical to be telling some agencies to cutback while asking for an increase for OMB. I subsequently reversed myself. I did not realize at the time that I said that just how thin OMB really was on this subject. I suspect a lot of people don't realize just how thin OMB is.

I mean, I have been in Government all these years and I thought of it as this big, potent organization, and I discovered that in this particular area it is exceedingly weak.

Senator LIEBERMAN. Sounds like the Wizard of Oz.

Mr. DARMAN. Perhaps, but in any case, I reversed myself relative to what I had said here, and I did subsequently ask for an increase in people, a modest increase in people for management, 20 some odd. And we have had the support of Chairman Glenn and others on the Committee in seeking those additional resources and we are very appreciative of that, and I believe that Senators DeConcini and Domenici will continue to be favorably disposed to that.

It is just a start, I'm sorry to say. It is a modest increment. I suspect there will have to be more. In addition, I have suggested—and this I did say at the time of my confirmation hearings—that there ought to be a deputy for management, solely for management, within OMB.

And there are a couple of values in that, several. First of all, the job would be defined, as I understand, for management, not for management and budget, or management and legislative affairs, or management of other interesting things around town, just management. So that person would come into the job with the expectation, I'm here for management, which is important if you go to my comment about the Hollywood East syndrome. It is someone who is

coming here with the idea that they are ready, willing, able to be committed to the nuts and bolts management side of the job.

Secondly, that is the expectation that others would have with respect to such a person. Not insignificant, I believe this Committee can play a very big role in helping—I know you already have—I think you too could play a bigger role with the oversight function with respect to management issues. And, it is a whole lot easier if you have got somebody you can hold accountable. So you can hold me partly accountable, but if you had a deputy for management, you could have that person—hate to say it since the person I have in mind is here—you could have that person up here every day of the week if you wanted.

Chairman GLENN. Is that a commitment?

Mr. DARMAN. But it is not a bad thing, because you need—you know, the system is somewhat responsive to pressure that comes from oversight and it is nice to have a pressure point. It is not so nice to be on the receiving end of it, but if we are really trying to solve a problem, I think it would be helpful to have a focal point that is accountable to this Committee.

That wouldn't be sufficient, but I think it will help address the problem that you are talking about.

Senator LIEBERMAN. I appreciate your answer. Let's do it.

Thank you, Mr. Chairman.

Chairman GLENN. Thank you, Joe.

To follow-up on that a little bit, you have 30 professionals. Okay. Fine. And they have \$40 billion worth of responsibility, if you divide the budget out to that level. And I don't think anybody expects those 30 professionals to keep up with every function of Government and make sure they are all efficient, but what they do rely on, what I rely on and what I thought was going on—maybe I am wrong—is that those 30 professionals were supposed to be trying to see that systems are in place, and they supervise the systems, they don't supervise every nickel and dime that is spent out there in those departments.

And I would think that maybe a Cabinet meeting—far be it from us on this end of the avenue to advise the President what to say in his Cabinet meetings, but we will anyway—why couldn't there be a Cabinet meeting where he lays this out cold turkey that it is up to the Department heads to put these controls in, and they have to be tight, they have to be given a priority, and not just look at a Cabinet position as a great honor for past whatever services were rendered here and it is a big honor and be here for a couple of years.

And the average Cabinet post is what? Two years, two and a half? And so they come in and it is a big honor and you have an office and you travel and you do these things. It is a big honor and meanwhile the business of Government goes on, by and large.

If those department heads and the people running the agencies had to put in these controls—and let me give you an example—you have management by objective. Okay. Fine. I agree with management by objective, and I have all the testimony you submitted to us this morning on all the things of the different departments here, and each one of them had to draw up their particular priority areas, and I agree exactly with those, they are great, they are fine. I don't disagree with any of them. You have to set up what they

want to do as their priorities, they select milestones, they selected them, it is up to them to do those things. And that is all fine and they give a milestone under each one of their overall objectives.

I don't find though, in any one of them—and I read through them all last night—I don't find in a single one of them anything about the efficiencies of Government and putting in audit controls, management controls that are going to make certain that we don't run into more HUD situations down the road.

Now, it would seem to me that we do finally get to one back here when we come for the MBOs for the Government management and integrity, the President's Council on Integrity and Efficiency to guarantee the effectiveness and integrity of programs and services to the public and the proper stewardship of public resources, select milestones, install and operate an integrated Government-wide network of financial management systems by 1992.

And then the rest of them are sort of vague—enhance top management's decision-making capability and things like that that are vague and anybody could have written the rest of them.

But now, what are we going to do to install and operate in every department of Government a Government-wide network of financial management systems by 1992, number one, and why isn't that made—if this is important, and we know it is—why isn't that made an item in every single MBO of every department of Government?

I don't expect you in your Office of Management and Budget to go out there and run these things, but I think too often we have people come in, well, they are here for a short period of time, let's do what we can here, it is a great honor and I got appointed to this position, will be here a couple of years, and I hope the IG doesn't catch something wrong on my watch.

I would think the President could call a Cabinet meeting and say, we are putting this down here as a priority item, and if he doesn't, you are not going to be able to take 30 people and ride herd on this whole Government. You couldn't possibly do that.

How much confidence do you have we don't have another brewing HUD scandal out there?

Mr. DARMAN. I'm sorry to tell you, I'll bet we do.

Chairman GLENN. Do you have any idea which department?

Mr. DARMAN. No. But I can tell you that if you look over—I'll tell you—I mean, I'm sure you know just as well as I do, Mr. Chairman, but let me give you—

Chairman GLENN. I know some places that look pretty gray to me.

Mr. DARMAN. I think it is totally unfair to just single out a department and say it is going to be another HUD, because it will be misinterpreted by some of the people in the room and we'll have a big front-page story.

Chairman GLENN. Well, let's take it the other way. How many do you have confidence in that there will not be another HUD, then?

Mr. DARMAN. Close to zero. But, you know, if you were to take an indicator—and it is a very crude indicator, but it is one that worried me—if you say before the HUD scandal broke what had been reported as material weaknesses in the system that you know and I referred to—

Chairman GLENN. Yes.

Mr. DARMAN [continuing]. And you looked by agency at the number of material weaknesses outstanding that had been identified in the system—and you have this data as well—you don't find HUD at the top of the list, even though HUD had been identifying its problems. It is not as if HUD had failed to identify the problems. They just failed to act on the problems that had been identified.

So if you look over the list just within that system—which I think was a flawed system for even reporting how much weakness there is out there—HUD wasn't, by that crude statistical measure, the worst. It was in the middle of the pack.

Now, that should at least lead one to worry that any number of other big problems are still looming out there. Now, I think we are doing a pretty good job of trying to get on top of these as quickly as we can with limited staff resources. I agree with you completely, you cannot do it all, never should aspire to do it all in OMB or any single agency, even if it were a separate management agency.

It has got to be done through the lines all the way down through this complicated system. But you do need the right systems and the right oversight. And I said at the outset, I don't think OMB has been given enough oversight. I may say I think that others are not given as much oversight as could be given as well. In any case, you have got to use some people to perform integrated oversight. It takes a good fraction of those 30 people just to start doing the oversight of the systems sensibly.

Chairman GLENN. Any big corporation that has a \$1 billion sales, or management problems there—I was with the Procter & Gamble people a couple of nights back here, they were in town. They have \$21 billion sales now in that company, huge, all over the place. GM is what, \$60 billion, \$70 billion a year? I think there are only four or five countries in the world that have a bigger budget than GM.

Now, you can bet that they have these controls, and audit controls and management controls right down to the lowest level.

Why can't we do that in Government?

Mr. DARMAN. We can, sir, but it is going—

Chairman GLENN. And that should be what your "M" is overseeing. You shouldn't be required to run a line item on every IG report on how \$16 got spent wrong some place. You should be overseeing these systems in place and making certain that they are operating, and that we never get to IG scandals.

Mr. DARMAN. I agree with you, but my theory has been this, and I'll bet it is—let's put it this way, prior theories haven't worked, I think this one has a chance, and let me say what it is.

My theory has been this, that we should take advantage of the HUD scandal as an opportunity to force a review of all of these material weaknesses, to scare departments and agencies into the possibility that they are going to see theirs on the front page of the Washington Post, New York Times, and various newspapers in Ohio and elsewhere. And that out of that they will gain an interest in implementing the basic systems necessary to prevent this in the first place.

In other words, if you start with just the systems, people just don't adequately respond. You have got to start with where they

live, which is fear of what is on the front page of the newspaper, for better or for worse.

Now, that said, we do have—and I suspect you are familiar with this—a blueprint called Core Financial Systems Requirements, that was developed jointly by Treasury, OMB and the GAO, that does outline in some detail where the systems are supposed to be going. I reviewed this and found this to be a little inadequate. I felt that this, itself, needed to be converted into specific timetables for implementation with specific management plans for getting this implemented.

So we have started that process and that is being tracked through the MBO system. It cross-cuts all of the agencies, and just because it only shows up once in the list that you have there doesn't mean it isn't reviewed with respect to every agency. It will be.

Chairman GLENN. Well, the HHS IG testified department managers are stating they have no material weaknesses and only the IG auditors are finding them. So they are just not on top of their own situation.

My time is up here, but I would love to see the President call a Cabinet meeting and say, here are your marching orders, fellows, and ladies, and you are to put in controls and audits, and we see from the IG reports now we have been lax in this area, we see a big problem there, and we got more HUD stuff there in those departments even you Secretaries don't know about, and Dick Darman is going to tell you how to do it. And stand up there, and then you are going to follow-up and see that they get implemented.

Now that would put the "M" in OMB.

Mr. DARMAN. Mr. Chairman, he did do that once for the Cabinet. He also did it for most of the major independent agencies. But the reality is that, as you know, a President says to do things, Cabinet officers say they will go do them. If you don't have the attention to the follow-up in detail with some people who are not the big shots in the system, it just doesn't get gone, and we are working on the latter as well.

Chairman GLENN. I think that is pretty fundamental if we have a Government that is going to be in control. Like any big business or corporation, you have to have those.

Mr. DARMAN. I agree.

Chairman GLENN. My time is up. Senator Kohl?

Senator KOHL. Thank you. I would just like to briefly ask you about a parochial question, a request that I have. I introduced a bill to ban the production of biological weapons a few months ago and it has been through the process. My understanding is it is at the moment languishing in OMB. We are waiting for the Administration's comments on it.

Could you just check it out and see, the biological weapons bill?

Mr. DARMAN. Sure.

Senator KOHL. I would appreciate it.

Mr. DARMAN. Could I clarify, when you say "languishing in OMB"—

Senator KOHL. Well, maybe that is not a fair word. My understanding is that it is awaiting some comments or approvals from OMB. I think I overstated that.

Mr. DARMAN. I just wanted to clarify what OMB's role is. On an issue like that, OMB acts as a kind of honest broker, getting the views of the State Department, Defense Department, NSC and so on. And normally there is no reason for OMB itself to delay a response, other than that there may be some conflict among the agencies it is trying to resolve.

Senator KOHL. I would appreciate it.

Mr. Darman, I would like to ask you about the economic assumptions that we used in projecting our budget. As you know, it is a very difficult business, the projections, and as you know, OMB is charged with the responsibility of making economic and technical projections. And whether or not OMB has done so in the past, it seems to me the ability and sometimes the temptation of OMB to twist numbers and come up with numbers that suit the Administration's desires and needs are pretty strong.

Legislation, Mr. Darman, has been introduced to deal with this. Under the legislation, the Congress would be bound by the CBO economic and technical assumptions, and any budget agreement the Congress and the Administration reach would have to meet the targets as scored by CBO to avoid a point of order in Congress.

I'm interested in your opinion on using the CBO estimates, requiring Congress to use CBO estimates instead of OMB.

Mr. DARMAN. Well, Senator Kohl, the Congress is under no obligation whatsoever to use OMB's economic estimates in the budget process. The Congress tends to rely more on CBO and the Budget Committees but have from time to time, of their own volition, decided to use OMB numbers, or numbers in between.

I don't think I should presume to tell the Senate or the Congress how to do its business, but I would have thought that you might wish to preserve your own ability to make your own independent judgment. If I were in your position, I do not believe I would wish to be dependent on taking whatever CBO gave me, especially in a field that is so fallible and so subject to both honest error and political manipulation.

Senator KOHL. Correct me if I'm wrong, if we would be bound to use the CBO numbers, then in any conflict with you, we wouldn't have any way to maneuver around it or to use numbers or to—

Mr. DARMAN. Well, could I give you an example of where that turns out to be the case? For example, in all tax matters the Congress has decided that it is to be bound by the estimates of the Joint Committee on Taxation, and therefore, what the Administration says is irrelevant. I mean, we have been right sometimes, they have been right sometimes, but what we think is of academic interest, small, but it is not significant.

And the only question is do you want to turn over a kind of absolute power to a group of non-elected people? I would have thought not. I would go to Senator Pryor's point, who is governing, his question, who is to govern?

I would have thought it should be you.

Senator KOHL. But you know and I know—you know perhaps better than I know—that the way in which we have gone about making our projections have had a lot to do with the deficit numbers that we have, and it is because they are made by people who are partisan. And there is no way—there is no perfect way because

we don't live in a perfect world, but it seems to me that if you use a supposedly nonpartisan group to make your projections, over the long haul you are going to have more nonpartisan projections than if you use groups who have a vested interest in seeing the numbers go one way or another.

Mr. DARMAN. That would be true if you could assure yourself that that organization with that power would in fact be nonpartisan. I have had a certain amount of experience with estimates from that agency and they do a fair job, an honest analysis on, let's say, 80 some odd percent of the cases. On some other percent of the cases they come under enormous influence from the party in power in the Congress, and the estimates reflect it.

And, by the way, they are many times wrong. I would just—I'll go back to my position that I shouldn't advise you, but if you asked for my advice, which you did, I would strongly recommend you preserve some discretion in your own hands to make an independent judgment. You know as a former businessman you paid outsiders, professionals, supposedly neutral, to give you honest analysis of the data, but you didn't turn over to them the automatic power to influence something by giving you that report. You relied on them, I'm sure, but you made your own independent judgment if you wanted to accept or reject their advice.

And so, I would just urge you to preserve a similar relationship with CBO.

Senator KOHL. Thank you. Thank you, Mr. Chairman.

Chairman GLENN. Senator Lieberman?

Senator LIEBERMAN. Thank you, Mr. Chairman.

Just one final line of questioning, Mr. Darman, about another aspect of your management functions. And again, this shows how wide your responsibilities are with a relatively small staff.

I have been hearing a growing chorus of concern, complaints, anger, about the role that OMB has played in its regulatory review authority, which is part of the management function. And certainly the charge is—and I'm sure it will not be new to you—that OMB has gone well beyond its statutory authority to block or alter regulations for philosophical or political reasons and in doing so has frustrated the will of Congress as expressed in statute. I hear this particularly from environmental and consumer groups.

What is your response to that and what, if anything, do you intend to do to try to make sure that OMB is not abusing its regulatory review authority?

Mr. DARMAN. The only part of what you said that surprises me, but I think I could explain it, is when you said you have been hearing the chorus to be "growing." I would have thought the trend should be the other way, declining, but when I pause and ask myself why might it be growing, I suppose it must be because the OIRA reauthorization is topical now and being reviewed.

Senator LIEBERMAN. I think that is part of it. There is legislation before this Committee, as you know, that would restrict your role there.

Mr. DARMAN. Right, but that must be what accounts for the growth, because it cannot be our behavior. Our behavior is going in the right direction.

Senator LIEBERMAN. Tell me about that.

Mr. DARMAN. Well, you may recall when I was testifying at the time of confirmation, I was asked about this subject and I said, among other things, that I thought—although I realized that others contested this within the Administration—I thought that OMB had abused the process by using delay as a substantive tool.

Senator LIEBERMAN. Right.

Mr. DARMAN. I mean, it is procedural, but using it to advance substantive interests. I said I thought that that was inappropriate. Upon being confirmed, I immediately said we weren't going to do that, so I instructed OIRA to set up an internal reporting system to sort of do an age of the inventory. The initial effort at that was not perfect. A subsequent refinement I think is a whole lot better. I think you will find most of the agencies are now saying they are not experiencing the problem of delays that they used to experience with OMB, and certainly the average age of inventory is declining.

Senator LIEBERMAN. Good for you.

Mr. DARMAN. And the two agencies that had complained most in the past could be good witnesses on this. One is EPA.

Senator LIEBERMAN. Right.

Mr. DARMAN. And the other I think is Labor, especially because of OSHA.

Senator LIEBERMAN. Right.

Mr. DARMAN. I think you will find that both Secretary Dole, who was concerned about this on the way into office, and Bill Riley, who was concerned on the way in, both of them will say that the performance and the relationship with OMB is much better than had previously been the case.

Now, there is another kind of problem which is not to use delay to advance substantive interests. That one, I think we are fixing, or have fixed, largely. And that goes to the question of what kind of issue can OMB look at in the first place. Is it supposed to look only at the—under the Paperwork Reduction Act—the paperwork burden? Probably, the answer is close to yes.

But under other authorities, including inherent presidential powers, as interpreted by the Executive Branch, and to some degree by the Courts, can it also look at a host of other considerations? That is where you get into a degree of trouble with people in the Congress, especially those oriented towards more aggressive regulations, because from our perspective we tend to apply more critical analysis to risk assessment, to cost/benefit considerations and so on.

In some cases, the statute will say that you can't do that. In those cases we cannot do it. And, in those cases the internal instructions are don't. You are not supposed to go against the existing statutory authority. That is a separate policy matter.

In other words, we could perfectly well come around under another heading and say we would like to change the statutory base and do the analysis that says that and make a case to the Congress to change the statute. But you cannot go against the existing statutory base in the implementation of a particular regulation or the analysis thereof. That is a rule.

There is still a gray area, and it is a gray area where we probably will continue to have some conflict because we will interpret

our responsibility to extend beyond the perspective of the particular agency.

Senator LIEBERMAN. I appreciate your answer, and I would say a couple of things in response. Clearly, it is the feeling of some groups that in the past OMB has gone over the line, even where statutes suggested it did not have authority, to frustrate the will of Congress. So I thank you for your directive to your folks not to do that.

In the gray area, as you describe it, probably there is an inevitable push and pull between Executive and Congress, and I'm sure we'll keep pushing and you'll keep pulling.

In terms of the delay, I again appreciate what you have said. Senator Bingaman has a bill before this Committee which does set some statutory time limits for OMB review of regulations.

Would you support those?

Mr. DARMAN. We support the time limits with respect to Paperwork Reduction Act authorities. Where we have a problem is with respect to our regulatory review independently of that. Our problem is not with the time limits, our problem is with the question of whether they should be statutorily set, since we believe that our authority to act in this area is an inherent presidential power and doesn't derive from any statute in the first instance.

What I hope we could do on this is something that was done, as I understand it, in 1986 with Senator Levin, I believe, where a side agreement was reached that has been honored—I believe he is quite satisfied with its implementation—but it doesn't have the force of law. So we avoid the sort of separation of powers argument and come up with some way to codify an understanding among the key parties as to how we are going to behave, but it isn't in law.

We are working with his staff and the staff on the House side and Senator Glenn's staff and others to see if we can find a compromise here. I can only say that we are extraordinarily reasonable. [Laughter.]

Senator LIEBERMAN. Thank you. My time is up.

Chairman GLENN. A couple of questions and a comment before we end. You have been very patient with us and we appreciate that.

Number one, on these charts up here on the wall,¹ these are just little one-line summaries of things that the IGs have come up with.

Were you aware of all those problems up there, or do some of these come as a surprise to you?

Mr. DARMAN. I'm just quickly checking. Okay. The first one—do you want me to run down them? Almost all of them were not surprises to us. In fact, almost all of them made our own high risk list, the list that I mentioned that we are monitoring.

That is true of number one, the first one, the HCFA procurement, that is on our high risk list.

The next one, State's failure to identify requirements for major telecommunications and information systems procurements, that was not raised with us either by the IG—I might say, Mr. Chairman, I believe you are aware, in addition to the formal system I

¹ See p. 296.

mentioned, we felt we needed a supplementary sort of informal system where we would meet one on one with each Inspector General just to double check to see if the Inspector General might have had something in mind that didn't make it all the way through the formal report. That didn't make it in either the formal report or the informal one.

The next one had been raised. The next one, the untold millions in reduced EPA fines, and so on, that is on our high risk list.

Chairman GLENN. Can we get a copy of your high risk list? Do we have a copy of that?

Mr. DARMAN. I think you do. We would be happy to provide it to you.

Chairman GLENN. I would like to have a copy. Thank you.

Mr. DARMAN. I would suggest, but not insist—and probably there is nothing I could do about it any how—suggest that you might want to hold that moderately closely, but—

Senator GLENN. All right, we will.

Mr. DARMAN [continuing]. It probably won't do any good and we'll all be reading it in the newspaper, maybe even before you get it, but—

Chairman GLENN. Never at this end of the avenue.

Mr. DARMAN [continuing]. In any case I think it is a little bit like a bank advertising the days on which there is no one watching the vault. [Laughter.]

But we ought not to publish the high risk list, but I'm sure we will accidentally do so.

Chairman GLENN. No, we'll keep it under wraps here. We will.

Mr. DARMAN. I know, but I'm just not convinced that somehow or other our—somebody will file a freedom of information request and it will be in the Washington Post. But any how, we'll give it to you, sir, if you don't already have it.

Chairman GLENN. Freedom of information would be filed against the Executive Branch, so it would come from over there.

Mr. DARMAN. Right. [Laughter.]

Chairman GLENN. Okay. Had you considered in your new budget that will be submitted in the not too distant future that in your new budget maybe you should be putting in perhaps a line item in each department of money specifically in there for internal audit and management purposes, a line item, and that you will advise them on how you want that thing set up?

Now, I would support something like that. I would fight like the dickens to get whatever money you want for something like that, because, as you pointed out, 30 people aren't going to run the whole United States Government on an efficient basis. But you can have 30 good people and yourself that can supervise the putting of controls and audits and management controls down into these places. It will cost some money, but could that be considered? Is that a way of getting their attention on this, and then holding their feet to the fire on putting it in?

Mr. DARMAN. Yes. What I have done is suggested something that is related to that very closely. I'm not sure if you are aware of this or not, but my predecessor had requested an \$86 million fund that OMB itself administered to try to force management improvements into the agencies. I thought that was a bad idea, that what we

ought to do instead is use our much larger budget review process to go agency by agency and decide what ought to come out of its own budget and be appropriated directly for the purpose of this management improvement.

So in each of the agency budget reviews we have a priority set of management related things we are trying to get implemented in our own budget with line items associated with it. And in several of the cases that will involve improving the financial control systems.

Chairman GLENN. Okay. We want to wind this up very shortly here, but I just want to come back to Jim Sasser's comments a little while ago here and give you, in about one minute here, my views on some of this. I have views that I'm against everything, at least at the moment, until proven otherwise, in that—let me go back a little bit on some things that happened in this very room back not long after I came to the Senate.

I was working with Senator Ed Muskie then, who was very hot for some of the zero-base budgeting ideas in which each department would have to rejustify its existence and its programs on some sort of a basis every 5 years, 10 years, or whatever. It finally got to be, in looking at it, such an enormous job, we decided on a 10-year basis and there would be certain functions that would have to come up and rejustify their existence every 10 years, and those that couldn't justify, why we would terminate. In other words, everything would have sort of a leash on it over a period of time.

But that isn't the main point. The main point is at that time we estimated that revenue the Federal Government did not collect due to tax incentives or preferences of one kind or another, was about \$126 billion a year. In less than a 10-year period when we were building up to consideration of the Tax Reform Act of 1986, we estimated that that revenue foregone, the revenue that we did not get because of tax incentives of one kind or another, exceeded \$400 billion a year. Enormous.

We were basically running our economy, skewing it all around with tax incentives, and that was really the driving force behind the Tax Reform Act of 1986. We had to get control of that incentive and loophole and preference area. At the same time when we pulled that down, we would pull the rates down and get this thing back under control again.

Now, we hardly have the ink dry on all this and here we are arguing over how we are going to give money away to who, and the big problem isn't are we going to, it is a question of how are we going to do it, with capital gains, or IRA's or whatever. And that is my problem. Here we go again building up to the Tax Reform Act of 1996 instead of 1986.

So I may be convinced one of these days to vote one way or the other, I don't know, but right now I would have to be in that column that says that I just don't think we are wise to start up that track again long term-wise for this country. Plus, I read even in the Wall Street Journal about how we cannot really correlate capital gains reductions or increases, either one, with what happens to business investment.

The biggest business investment we have ever had in venture capital was in 1987 when we had just put capital gains tax up to 28

percent from 20 percent. Now, there were other factors, foreign investment and other things came in. But the correlation which several writers have written on recently, that being one of them, and the New York Times also had some things I believe, about there is just no clear cut correlation between that tax rate going up and down and what it does to investment capital.

Plus, I just have trouble thinking we ought to be, with whatever the vehicle, that we should be starting up this tax incentive thing again, and pretty soon we'll be back up there again one of these days and we'll be having a Tax Reform Act of 1996 to correct all these inequities and go through all that 2-year trauma like we did building up to 1986.

I just throw that out for free. That is not the purpose of our hearing this morning, I know that, but it was brought up and it was discussed.

Now, how do you respond to that, that here we go up the old tax incentive problem curve again?

Mr. DARMAN. This is the way I would like to respond, Mr. Chairman. As you know, the tax reform movement started, most people would say, with Stanley Surrey in the Kennedy Administration. He had a basic theoretical argument which was that you shouldn't have any tax expenditures and that on the tax side all income should be treated identically; that had been the basic reform principle pushing so-called tax reformers in the academic mode for many decades without there being any movement at all in the legislative process. There have been a lot of failed efforts at tax reform.

The 1985, 1986 movement was a little different, I believe. I don't think it was rooted so much in the Stanley Surrey philosophy, although there were some who were for tax reform because of that. For example, Bill Bradley I think to a very considerable degree was following in the Surrey tradition. But a lot of other people had other motivations. For example, people had come to feel that the tax system was extremely unfair for a variety reasons, legitimate reasons. And other people had come to feel that the rates were too high, or that the combination of Federal, State, local, property rates, put them so that they were just terribly negatively disposed towards the whole tax system. There is a kind of populist dimension to tax reform that was not at all associated with the earlier academic interests.

Now, when we ultimately moved it through the political process, the Stanley Surrey principles were not attended to at all. The reality is that if you look at tax reform as it was ultimately enacted, there was every bit as much in the way of tax expenditure—in fact it is right in our budget this year, several hundred billion dollars worth of tax expenditure laid out item by item in the current law. That was not reformed.

What the reforms were, as it turned out, were a lowering of rates, which creates a disincentive to go use some of these, what some people would call, loopholes or tax incentives, and an alternative minimum tax which said, if you go out and use them—you are free to use them, the political system is going to tell you there is an incentive here, there is another one, here is one for child care, which is not current law; here is one for health insurance, which is

in the current law; and here for cafeteria benefits, which is in the current law; here is one for oil, which is in the current law, and these are all still in the law.

But if use them all, you are going to have to come out and at least pay something that approximates your fair share under the heading, the alternative minimum tax. That's the way reform worked out in practice.

The Surrey way would never have had an alternative minimum tax. The Surrey principles, if applied, don't require an alternative minimum tax because there is nothing that people can go use as a tax preference or advantage that they then would have to turn around and be taxed on. Or to put it another way around, the receipts under the alternative minimum tax would be zero in a Surrey world.

But that is not what we got. We got this different world. Now, the point I would make is that I think it is important to keep the low rates for all the good reasons associated with them. It is important to keep the alternative minimum tax to preserve some confidence in the system and sense of fairness. It is important to preserve the rules against paper losses and unproductive investment and gaming of the system through that.

But it is perfectly legitimate to say, do we think this is a good social purpose, or a good economic purpose, to use the tax system for? For example, to pick one I would hope you might be favorably disposed toward, the R&D credit. I think that is good public policy. I think that there is an insufficient incentive for research and development in the civilian sector, applied research and development, and that it is good public policy to have an incentive for that. If you were following the strict rule, you would say no, that shouldn't be there.

Now, it is on the same line of thinking that I say we need an incentive to make people more interested in long term investment and less interested in quick turnover. And that is what leads us to favor—or at least me to favor—the capital gains incentive. So I would like to record you as leaning favorably.

Chairman GLENN. That is a great leap of faith at the moment, but that is the way it goes.

Mr. DARMAN. Well, at least open to further discussion.

Chairman GLENN. Well, I am open for further discussion on it, but I am just not all that disposed, particularly where the past record does not really show that capital gains rates moving up or down really is the influencing factor on whether there is new investment or not.

Mr. DARMAN. One of the main reasons that is true, Senator, though, is not that there isn't a real effect, but it is that we have changed the law so often that it is very hard to design an academically responsible study that can separate out the different elements that contribute to the effect.

Chairman GLENN. Then that would argue toward letting the 1986 law then sit there for a little while before we tinker with it.

Mr. DARMAN. Only if you wanted a definitive academic answer. Another possibility is to say who cares, why not rely on common sense.

Chairman GLENN. That is what I'm trying to do.

Well, thank you very much. We will get back to you.

Senator Bingaman was unable to attend today's hearing but has some written questions to be answered for the record.¹

We have some other people I'm sure who were not able to be here this morning and will want to ask questions, too, and once we review the record we may have some also. We would appreciate your response to those.

We want to keep up with what you are doing over there in this area, and I'm sure you want to be apprised of what we are doing at this end of the avenue, too. And I would hope that we could make these sessions maybe once every 6 months or so so we can keep up with this.

Mr. DARMAN. I would be delighted. I would welcome it, and if you invite the deputy for management, he can come every week.

Chairman GLENN. You already volunteered him on a daily basis, so he is fully committed at this point.

Thank you very much. The hearing will stand in recess subject to the call of the Chair.

[Whereupon, at 1 p.m., the Committee adjourned subject to the call of the Chair.]

¹ May be found in the Committee files.

APPENDIX

HOLD FOR RELEASE
UNTIL DELIVERY
EXPECTED 9:30 A.M.
SEPTEMBER 28, 1989

STATEMENT BY
JUNE GIBBS BROWN, INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
BEFORE THE
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
ON
INSPECTOR GENERAL ACT IMPLEMENTATION

(153)

Mr. Chairman and Members of the Committee:

I am pleased to participate in this morning's hearing on Inspector General Act implementation. As you know, I have served as the statutory IG at three Federal agencies--Interior, NASA and Defense. I have seen the wisdom of the Inspector General Act of 1978 borne out many times over. In my view, agencies where statutory IGs were not established in the original Act were left trying to manage with one arm tied behind the back. The 1982 Amendments to the IG Act certainly strengthened the ability of the Department of Defense to fight fraud, waste and abuse by creating a statutory Defense IG. I am confident that the creation of statutory IGs in other agencies under the IG Act Amendments of 1988 will eventually be recognized by everyone, including those agencies, as a constructive step that facilitates better management.

IG SUCCESS TO DATE

Mr. Chairman, I have several suggestions for refining the authorities of the statutory IGs and improving the conditions under which they operate. I want to be clear, however, that I regard the IG community as having been extremely successful and my suggestions are not intended to imply otherwise. I can report

to you, for example, that the Office of the Inspector General, DoD, has achieved great success in our operations over the past few years, as have the DoD audit and investigative organizations functioning under IG policy direction and oversight.

Accomplishments include:

- creating what is, in my opinion, the finest fraud investigation organization in the world, the Defense Criminal Investigative Service, whose work has led to nearly 1,500 indictments, over 1,100 convictions, and monetary recoveries of \$685.5 million;

- issuing hard hitting audit, inspection, and other types of oversight reports leading to potential savings and cost avoidance of \$9.5 billion;

- improving the coordination and cooperation between the DoD and Military Department audit, inspection and investigation organizations; and

- providing leadership within the DoD in vital areas such as audit followup, Hotline operations, ethics training, fraud awareness, and improving contractor internal controls.

TOOLS NEEDED

Even more could be achieved in the future with certain additional tools, including:

-- Testimonial subpoena authority for statutory IGs.

The subpoena authority presently prescribed by section 6(a)(4) of the Inspector General Act is an essential, effective investigative tool, but it pertains only to records, papers and other documentary evidence. If a witness or person having relevant knowledge declines to be interviewed, currently we have to resort to grand jury subpoenas. That method is untimely and information obtained through the grand jury process can only be used for administrative purposes through rare--court approved--exceptions, a serious limitation.

-- Arrest authority. My criminal investigators are called upon to work in perilous situations, such as in undercover operations where suspects are armed. Yet we lack the fundamental law enforcement tool of arrest authority.

-- Policy direction and oversight authority for the Inspector General, DoD, over the inspection functions of the Military Departments and Defense Agencies that are directly

concerned with fraud, waste and abuse. The IG Act, as amended, gives the IG, DoD, such authority over DoD audit and investigative organizations, but not over the inspection community. I respect the need for DoD component heads and commanders to have control over inspection functions directly related to military readiness and operational matters. My office should have better means, however, to coordinate those inspection activities which are concerned with program efficiency and which can overlap DoD audit efforts.

OPERATING UNDER THE 1988 IG ACT AMENDMENTS

The IG Act Amendments of 1988 prescribed additional, detailed requirements relative to IG semiannual reports, the content of IG audit reports, the status of agency efforts to decide issues from those reports, and the status of agreed-upon corrective action. Since my office already collected that type of data in our role as focal point for DoD audit followup activities, we were able to easily comply fully with the expanded reporting requirements. In fact, we had already been including most of the same data in our semiannual reports. We have encountered no problems related to those IG Act Amendments.

I want to mention that the Deputy Secretary of Defense has taken a personal interest in ensuring continued DoD emphasis on audit followup. He sent all DoD component heads a memorandum clearly expressing his strong support of the program on August 16, 1989. In September, he signed a revision of the basic DoD regulation governing the internal audit followup program. The revised directive clarifies the responsibilities of the Military Department audit followup officials and incorporates lessons learned over the past several years, including recommendations by the General Accounting Office.

I am especially pleased to note that all DoD components cooperated extensively in drafting the revised directive and clearly support the audit followup effort.

IG TENURE

Finally, Mr. Chairman, you asked that I discuss the process for staffing the statutory Inspector General positions. Having served as the IG of three agencies, under three presidents, I do have strong personal opinions on the need to reinforce the non-political nature of the statutory IGs. Certainly, all major political parties and responsible public interest groups in this country agree that Government programs must be safeguarded from

fraud, waste and mismanagement. The fundamental missions of the statutory IGs are simply not partisan matters. Basic IG goals and objectives are not affected by political agendas, the rise and fall of budgets, or the relative popularity and visibility of individual Federal programs.

Last July I testified before the Investigations Subcommittee, House Armed Services Committee, on a bill (H.R. 2361) providing for a set term for statutory IGs. I endorsed that concept.

It is a credit to the professionalism and dedication of my past and present colleagues in the IG ranks that the objectivity of their reports and activities has not been impaired by the questions about their retention that arise even before each presidential election and then grow to a crescendo afterward. I think it would be wise to emulate the example of the fixed term of the Comptroller General of the United States and thereby remove perceptions that the activities of statutory IGs may be curtailed, slanted or even misused due to political considerations.

I want to be clear that I have never been told to alter a report or to do anything else that would compromise my professional principles and personal ethics. President Bush

went out of his way to meet with the IGs immediately after he took office and to express his support for our work. That was a magnificent and meaningful gesture. Unfortunately, the signals to us from others during the transition were quite mixed. In March, we (the IGs) were advised that our status was being reviewed. Each month this was reiterated at PCIE meetings, and the IGs operated under a cloud of uncertainty for many months. The first announcements are just now, in September, being made as to whether retention or reappointments are imminent. The question is moot for me personally, because in August I decided to pursue other career opportunities and am leaving my position as DoD IG next month. I can assure you that no one in DoD has given me anything but positive feedback on my performance and they have neither stated nor implied that I might not be retained. My decision was made for personal reasons. However, for the sake of the maximum effectiveness of the IG community, I continue to urge that the unique nature of the IG function be protected and the need to avoid perceived impairments to that function be recognized. To attract and retain the best candidates, appointments must--as required in the IG Act--remain:

"Solely on the basis of integrity and demonstrated ability in accounting, auditing, financial analysis, law, management analysis, public administration, or investigations."

Retention should not be based on the transition of administrations or on the IG's position on a particular matter, but on the entire body of work produced by the IG over a reasonable interval of time.

The IG concept is still relatively new and it is perhaps not surprising that issues such as this one still arise. In 1981, President Reagan fired me and all other statutory IGs, and then reappointed six of us a few months later. That experience, plus the current protracted period of uncertainty, leads me to endorse the fixed term concept.

DOD MANAGEMENT CHALLENGES

Mr. Chairman, your invitation letter specifically requests that I describe management problems facing the Department of Defense. When discussing problem areas identified in my office's previous work, essentially I will be recapping the voluminous semiannual reports that I submit to the Congress each May and November, as well as previous testimony by me or my staff to various Congressional Committees. I have advised the Secretary and/or Deputy Secretary of Defense, the Deputy Director of OMB, and other senior officials of those problems. Extensive measures are taken by DoD to keep management problems that have been

identified by auditors from being swept under the rug. The Department has sound, forthright procedures for evaluating audit reports, reaching well documented decisions on disputed audit recommendations, and following up on agreed-upon corrective actions.

I know of no other Federal agency that applies more intensive internal audit and audit followup procedures. Neither do I know of any Federal agency with more complex programs or formidable day to day management challenges. Many actions are underway to improve the weaknesses and problems I will discuss. My office's work over the past few years indicates the following management areas still contain a variety of challenges and opportunities for improvement:

-- Contracted advisory and assistance services.

Numerous audits have identified issues concerning the various types of consultants employed by the Government or by industry. The issues include defining who and what consultants are, the use of consultants instead of Government employees, the black market for contractor proprietary data, and the frequent lack of competition in awarding basic and followon contracts.

-- Defense acquisition regulations, procedures and practices. About 60 percent of my office's audit resources are devoted to coverage of the acquisition area. We have made hundreds of recommendations to improve various aspects of the process and we strongly support the initiatives outlined in the Defense Management Report to the President. One additional, emerging issue is the apparent inadequacy of controls over the use of interagency ordering agreements to bypass DoD procurement regulations. The Inspector General, Library of Congress, reported on this issue in August 1989. My staff is also finding significant control weaknesses in the DoD contracting for services and supplies through the Federal Library and Information Network (over \$80 million in FY 1988) and through other Federal agencies, where even larger sums are involved. We have issued one draft report on the matter and another is pending.

-- Compliance with established policies for weapon system acquisition decisions. Historically, both the Military Services and the Office of the Secretary of Defense have frequently deviated from the prescribed guidelines for providing documentation needed by decision makers at major weapon system program milestones. We have issued over 30 individual system or summary audit reports on the Defense Acquisition Board process since we were requested to initiate such reviews by the then Deputy Secretary of Defense Frank Carlucci in 1983. Our next

summary report will be issued in a few months. We also plan an active audit program in the future to support the Department in enforcing those requirements.

-- Test and evaluation. Recent audits by my office and by the GAO have identified two fundamental operational test and evaluation issues: (1) there is a need for clarification on what constitutes full-rate weapon system production, and (2) there is a need for clarification on what is considered adequate OT&E. Both issues deal with DoD compliance with the requirements of the test and evaluation statute enacted by Congress (Title 10, United States Code, Section 138). We also believe that management of DoD testing facilities could be strengthened to avoid duplication and to stretch limited testing resources farther.

-- Contractor oversight. The DoD is establishing a centralized Defense Contract Management Agency, which should help eliminate inefficient and duplicative oversight of contractors by various Government groups. Although some progress has been made in reducing duplicative oversight, more needs to be done. The problem lies principally in oversight reviews that are not audits.

-- Hazardous material and waste management. The DoD needs continued management effort at all organizational levels to bring its facilities and practices into full compliance with Federal environmental law. Two weeks ago we issued a final audit report stating that the Defense Logistics Agency did not always have effective visibility and control over hazardous waste during the turn-in, removal, and disposal process. Activities that generated hazardous waste frequently did not identify or accurately quantify what was being turned in for disposal. The DoD has recognized this area as having DoD-wide internal control problems and is attempting to correct them.

-- Financial management of security assistance programs. The DoD has been trying for several years to develop an effective accounting system for foreign military sales. The FMS Trust Fund is seriously out of balance. We recently completed a major inspection of the Defense security assistance function and the DoD is taking numerous management improvement actions.

-- Quality assurance and protection against nonconforming, substandard, and substitute products. Numerous reports by my office and the GAO have identified quality assurance problems that allow large quantities of inferior materiel to enter the DoD supply system. Mr. Vander Schaaf testified on our findings of quality control problems at the

Warner Robbins Air Logistics Center before the Committee in April 1989. Recently, our inspectors found similar deficiencies at two Defense Logistics Agency buying centers. Essentially, these are DoD-wide problems. In response, the DoD has prepared an "Action Plan to Improve the Quality of Spares and Repair Parts Through Reductions In Nonconformances"; however, we remain concerned that there is not enough emphasis on testing or on discontinuing business with poorly performing contractors. The DoD is also counting on its Total Quality Management initiative and on strengthened procedures for documenting and sharing quality deficiency reports among the DoD components to decrease the risk of nonconforming products entering our inventories.

-- Supply inventory management, including requirements determination, inventory control and physical security.

Mr. Chairman, your Committee has focused on a number of DoD supply system management problems in hearings over the past two years. Numerous audits have identified such problems as inaccuracies in requirements determination processes, failure to use long supply items as Government-furnished material, not terminating contracts for on-order excess spare parts, repairing unneeded items and not accounting properly for inventory. The DoD has acknowledged supply management as an area with DoD-wide internal control weaknesses. Many corrective actions have been

taken and others are ongoing, although progress in some is disappointingly slow. I understand that you intend to hold a hearing on that subject in the near future.

-- Management of Government-furnished property (GFP) in the hands of contractors. The DoD is still unable to reach internal agreement on the financial accounting requirements for GFP. The President's plan for consolidation of the contract administration function may provide a means of ending the 10 year long debate between the DoD components on this matter.

DOD MANAGEMENT IMPROVEMENT EFFORTS

All of the problem areas discussed above involve multiple problems whose elimination is a difficult challenge. DoD managers are working on those problems. While I am not always satisfied with the pace or scope of corrective actions, the considerable management effort that is being applied must be recognized. The DoD has carried out over 4,200 recommendations made by the IG, DoD, since 1982. Action is currently under way on over 1,000 other IG, DoD, recommendations. My staff tracks the status of each of them in our audit followup system.

CRIMINAL ACTIVITY

Despite the fact that the overwhelming majority of DoD employees and defense contractors are honest and competent, we will never ignore the distasteful reality that a criminal element does seek to prey on Government programs, including those of the DoD. Our action in those cases is aggressive and comprehensive. My criminal investigators currently have over 1,300 open cases involving illegal activity such as:

-- Product substitution. As of July 1989, the Defense Criminal Investigative Service has pursued 884 cases, of which 324 are still active, of intentional product substitution. Those efforts have resulted in 286 indictments and 116 convictions, with nearly \$18 million in fines, penalties, and restitutions levied. Defective and nonconfirming commodities have included such items as turnbuckles on parachute suspension cords, weapons parts, helmets, various electronic devices, and industrial fasteners. Due to the potential impact on force readiness and the safety of our personnel, product substitution remains our number one priority in the fraud area.

-- Bid rigging. The Federal antitrust laws were enacted to preserve free competition in procurement. They are the primary defense against unlawful attempts to limit competition

and thereby increase the purchase price of products and services. The Defense Criminal Investigative Service currently has approximately 55 pending antitrust cases which include bid rigging, bid rotation and price fixing. One ongoing investigation has disclosed that several companies conspired to rig bids submitted on a dredging construction project let by the U.S. Army Corps of Engineers in May 1985 for the dredging of the Delaware River from Philadelphia, Pennsylvania, to Trenton, New Jersey. To date, five individuals/corporations have been convicted and approximately \$4 million has been recouped in fines and restitution.

-- Theft of military equipment. Although not our primary mission, the theft of military equipment is an important concern of my office. We have been involved in a number of joint theft investigations with the Military Criminal Investigative Organizations as well as with the Federal Bureau of Investigation. Recently, as a result of an undercover operation which sought to identify and penetrate organized criminal activity involving the theft and fencing of stolen military property, agents were able to purchase three F-16 engines which were stolen from Hill Air Force Base. The value of the engines was placed at between \$1.4 and \$2.4 million each. In addition, approximately \$500,000 worth of additional stolen property was recovered.

-- Bribery. During the period of 1982 through 1989, the Defense Criminal Investigative Service opened over 300 bribery/kickback cases. As of August 1989, a total of 83 individuals have been criminally charged and 69 have been convicted of involvement in this type of criminal activity. Many of these indictments and convictions have been the result of joint task forces under the direction of U.S. Attorneys, consisting of representatives of the Defense Criminal Investigative Service, the Federal Bureau of Investigation and the Internal Revenue Service, as well as representatives of the Naval Investigative Service, the Air Force Office of Special Investigations and the U.S. Army Criminal Investigation Command. Task forces in the Philadelphia, Pennsylvania, Los Angeles, California, and Salt Lake City, Utah, areas have been quite productive. In addition, several other task forces have been formed in other portions of the United States and continued success in this area is anticipated.

-- Cost mischarging. Cost mischarging cases have been one of the highest priorities of the Defense Criminal Investigative Service since the agency's inception. These cases generally involve the intentional mischarging of labor and/or material costs relating to Department of Defense contracts. As of September 1, 1989, cost mischarging cases account for 192 cases, or 14 percent of the Defense Criminal Investigative

Service inventory. Since 1982, over 100 individuals and firms have been indicted, and over 75 subsequently convicted. Twenty-nine individuals were sentenced to a total of 60 years confinement. The total amount of fines, penalties, forfeitures, restitutions, recoupments, and recoveries exceeds \$250 million. Administratively, over two dozen individuals and firms have been suspended and over 50 debarred.

-- Intentional defective pricing. Defective pricing is high priority within DCIS and accounts for 149 cases, or 11 percent of the open case inventory. These cases relate to intentional deception in the submittal of cost and pricing data during the procurement process. Since 1982, over 75 individuals and firms have been indicted, with 55 subsequently convicted. Twenty-one individuals were sentenced to a total of 42 years confinement. The total amount of fines, penalties, forfeitures, restitutions, recoupments, and recoveries has exceeded \$1 billion. Almost four dozen individuals and firms have been suspended, and 18 debarred.

-- Medical fraud. Currently, the IG's Defense Criminal Investigative Service is involved in nine investigations focusing on medical fraud. These investigations impact on the Civilian Health and Medical Program for the Uniformed Services (CHAMPUS) and oftentimes are determined to involve a significant amount of

money. One such example is the current CHAMPUS investigation in the Southern California area which is, I believe, the most significant medical fraud investigation ever conducted. To date, this investigation has identified over 100 suspect medical providers and facilities, with six indictments or other judicial actions have been taken against those identified as culpable. In addition, several individuals have been locally charged with operating a medical facility and/or practicing as a medical provider without a license. Total losses to CHAMPUS and other insurance providers is estimated in the tens of millions of dollars. Additional indictments and substantial monetary recoveries are expected in this investigation.

As you know, I cannot discuss ongoing criminal investigations in depth. Instead, to give the Committee additional insight into the type of illegal activity we are detecting, I am providing several summaries of closed cases in an attachment to my written statement.

I would be happy to answer any questions.

EXAMPLES OF DEFENSE CRIMINAL INVESTIGATIVE SERVICE CASE RESULTS

- Clothing and Textile (Investigation of the Defense Criminal Investigative Service (DCIS) and the Federal Bureau of Investigation (FBI) -- BRIBERY AND KICKBACK)

The investigation involved the Defense Personnel Support Center (DPSC) in Philadelphia, PA. It was initiated based on information indicating that there was widespread collusion between employees of the Clothing and Textile Directorate (C&T), DPSC, to obtain preaward contract information, accept defective products, purchase defective material, alter testing results on fabric, and rig bids.

Seven DoD employees, including the Deputy Director of C&T and the former Deputy Director of the Defense Contract Administration Services Region (DCASR) in Philadelphia, were indicted or agreed to plead guilty to charges of racketeering, bribery, conspiracy, accepting gratuities, and tax evasion. About eight Government employees, not criminally charged, have been terminated from their jobs at DPSC and DCASR.

As of November 1988, 24 contractors have been charged in the investigation. Twenty-three have either pleaded guilty or have been convicted. There have been 146 suspension/debarment actions taken and more are anticipated. The investigation is still ongoing.

- Operation Defcon (Task force operation of the DCIS, the FBI, the Internal Revenue Service (IRS), and the Inspector General, National Aeronautics and Space Administration -- BRIBERY AND KICKBACK)

The investigation centered around the purchasing agent of a prime contractor who had control of the awarding of subcontracts and purchase orders to vendors and suppliers. Since the inception of Operation Defcon, there have been over 31 indictments and convictions. Twenty of the 31 were sentenced to an average prison term of 1 1/2 years, 2 1/2 years' probation, and an average fine of \$5,800. Over 80 percent of those convicted went to jail. The defendants pleaded guilty to a number of different offenses, including violation of the 1986 Anti-Kickback Act, mail fraud, and tax evasion.

The task force continues and has subsequently developed information that implicates over 200 individuals and companies involved in similar activity.

- Aircom Fasteners, Incorporated, and Yamaguchi-Seisakusho Company, Ltd. (Investigation of the DCIS, the U.S. Customs Service, and the Nuclear Regulatory Commission -- PRODUCT SUBSTITUTION)

An investigation resulted in a 34-count indictment alleging that Aircom and Yamaguchi designed a scheme to falsely mark and manufacture substandard and subquality fastener products such as screws, nuts, and bolts. If convicted, Aircom could be fined over \$6 million and Yamaguchi up to \$3 million. Six corporate officers face up to a total of more than 300 years in jail and fines of more than \$14 million. Japanese foreign nationals face criminal fines of over \$3 million and 78 years in jail.

• Genisco Technology Corporation (Investigation of the DCIS and the FBI -- PRODUCT SUBSTITUTION)

Genisco pleaded guilty to four felony counts as a result of a plea bargain agreement. Genisco manufactured faulty pressure transducers used by the DoD in the Navy High Speed Antiradar Missile; the Coast Guard HH65A Dolphin Search and Air Rescue Helicopter; the Navy MK-27 Mobile Underwater Target Device; and the Navy Torpedo Instrumentation Exercise Section, used to test all MK-48 torpedoes. The corporation was placed on five years' probation and paid \$725,000 in criminal fines and civil restitution. All faulty pressure transducers supplied by Genisco were removed from the DoD items mentioned above.

• Sundstrand Corporation (Investigation of the DCIS, the FBI, and the IRS -- COST MISCHARGING AND GRATUITIES)

Sundstrand concealed millions of dollars in cost overruns, provided illegal gratuities to DoD personnel and their spouses, and submitted fraudulent claims to the Government, which included millions of dollars in unallowable costs. Sundstrand agreed to pay \$115 million in fines, penalties, and restitution.

• United Chem-Con Corporation (Investigation of the DCIS, the FBI, the IRS, and the Inspector General, Small Business Administration (SBA) -- BRIBERY AND FALSE CLAIMS)

United Chem-Con manufactured fuse cables, which are detonation devices for bombs used by the Navy on A-4, A-7, and F-18 attack aircraft. Fraudulent progress payment requests were submitted to the DoD, fraudulent applications for business development expense funds were submitted to the SBA, and a Government official was bribed. Total fraud exceeded \$15 million. Seven officials pleaded guilty and sentences ranged from one to seven years, with fines imposed.

• Continental Chemical Corporation, and Abraham Ashkin, Chairman of the Board (Investigation of the DCIS and the Inspector General, General Services Administration (GSA) -- PRODUCT SUBSTITUTION)

Continental Chemical supplied the DoD with military purging fluid used to purge fuel tanks of military jet aircraft operated in very diverse climates. Ashkin and Continental certified to the DoD that the purging fluid met or exceeded the requirements of the specifications, while independent tests conducted by the Government revealed that the fluid was nonconforming. Deviation from the requirements could result in loss of life or damage to military aircraft. They also supplied several other nonconforming products to the GSA.

Ashkin and Continental Chemical pleaded guilty and the Government recommended that Ashkin receive an executed sentence, a \$25,000 fine, and be placed on a three-year probation. Ashkin faces a maximum fine of \$250,000 and five years in jail. The corporation faces a maximum fine of \$500,000 on each of two counts.

• Eaton Corporation, AIL Division (Investigation of the DCIS and the FBI -- FALSE CLAIMS AND GRATUITIES)

The AIL Division produced Defense avionics systems for the B-1B bomber. The AIL made false statements in monthly billings and received payments far in advance of when the contract allowed payment. That improper billing practice gave AIL a windfall of over \$3.8 million. The administrative settlement required that AIL pay

\$6 million in satisfaction of the claims, which included a \$500,000 penalty for the gratuities furnished, as well as \$700,000 in penalties for the progress payment dispute. Additionally, AIL agreed to absorb their own legal fees and expenses of approximately \$3.5 million.

- Delco Wire and Cable Company, Incorporated, Delco Electronics Corporation
(Investigation of the DCIS, the FBI, and the IRS -- BID RIGGING, PRODUCT
SUBSTITUTION, AND BRIBERY)

Delco sold substandard/nonconforming electrical and electronic wire cable to the Government. Delco and its related firms also bid against each other, giving the appearance of competitive bidding, and paid bribes to procurement agents. Due to the serious risk of using low quality and defective wire in critical applications, the DoD was involved in an extensive recall program. Delco faced a maximum penalty of \$12.9 million in fines, restitution of over \$500,000, and forfeiture of all corporate assets. The former secretary/treasurer was found guilty, along with several other officials. Jail sentences and criminal fines were imposed.

- Bell Helicopter (Investigation of the DCIS, the Army Criminal
Investigation Command, and the Defense Contract Audit Agency -- DEFECTIVE
PRICING AND COST MISCHARGING)

Bell Helicopter agreed to an administrative settlement of approximately \$90 million for cost mischarging and cost overcharging on Army helicopter spare parts inventories, timekeeping, and salaries.

STATEMENT OF JOHN C. LAYTON

INSPECTOR GENERAL

DEPARTMENT OF ENERGY

BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

SEPTEMBER 28, 1989

Mr. Chairman, I am pleased to have the opportunity to discuss, as you requested, some of the major challenges now faced by the Department of Energy.

Your letter of September 18, 1989, specifically mentioned three issues of particular concern. I will briefly summarize these issues and my views before discussing them in more detail.

The first issue is environmental compliance problems at the Department, including, to the extent possible, any comments I can make concerning criminal investigations.

We have recently issued two reports in this area. One of the reports concluded that the DOE had major deficiencies in its approach to assuring compliance with environmental laws, and the other found weaknesses in the DOE Environmental Survey Program. In addition, we have approximately 14 open investigations looking into various allegations of environmental wrongdoing. Included in these cases are joint efforts with the Environmental Protection Agency and the Federal Bureau of Investigation at Rocky Flats, West Valley, and Fernald.

The second issue is the policy implications and practical problems concerning the Department's policy of indemnifying management and operating (M&O) contractors for all expenses.

In our recent report on indemnification we found that the Department's fundamental policy is, with few exceptions, to completely indemnify its M&O contractors. With the implementation of this policy in the field, it is a rare event when DOE disallows costs incurred under these M&O contracts. For example, at one site, roof replacement contracts originally totaling over \$1.5 million were fraudulently awarded by a procurement supervisor. This and subsequent fraudulent acts resulted in over \$3 million of unnecessary costs being paid by DOE, to include \$420 thousand of stolen money and materials. Since the supervisor was not determined to be "managerial personnel" under the terms of the contract, these costs were allowable.

The third issue is the degree of DOE oversight of allowable costs in the aforementioned contracts.

We believe that the M&O contract concept and the way it is structured significantly impacts on the identification of unallowable costs. As a result, costs incurred by M&O contractors are very infrequently disallowed. The two major ways that costs are avoided within the Department are through management oversight of the contractor's work and audits of operations to identify management actions that could prevent wasteful or unnecessary expenditures.

I now will describe in more detail some of the Office of Inspector General activities in each of these three areas.

DOE'S COMPLIANCE WITH ENVIRONMENTAL LAWS AND REGULATIONS

The Department's activities have generated considerable radioactive and hazardous wastes. The minimization, clean up, and management of waste materials is one of DOE's most challenging problems. Estimates to clean up these wastes range from \$100 billion to \$150 billion. The Department's stated goal is to clean up all its sites within 30 years, and it plans to spend \$19.5 billion on these activities through 1995.

Since the late 1970s, numerous audit reports on the status of DOE's compliance with environmental laws and regulations have been issued. For example, in August 1981, the General Accounting Office (GAO) issued a report entitled "Better Oversight Needed for Safety and Health Activities at DOE's Nuclear Facilities." In this report, the GAO concluded that major changes were required in the safety and health oversight program at DOE's contractor-operated facilities to ensure that safety, health, and environmental standards were met. As required by statute, we consider GAO's work in this area when planning our own.

I would like to discuss some of my office's efforts in these areas.

FLASH REPORT ON COMPLIANCE WITH RCRA

First, I would like to highlight a recently issued Flash Report, entitled, "Compliance with the Resource Conservation and Recovery Act (RCRA) and Other Environmental Requirements". This report, although interim in nature, represents an overview evaluation of the status of DOE's compliance with RCRA at the time of our audit in early 1989; the adequacy of actions in process or planned to attain or maintain compliance; and the actions taken by the Office of Environment, Safety and Health to provide the necessary guidance and oversight on environmental matters.

The audit disclosed that DOE did not have reasonable assurance that RCRA requirements and RCRA violations were promptly identified and addressed. We found that attempts were made to identify such requirements and violations, yet, the Department had not established a systematic and thorough approach to focus management's attention on environmental cleanup and compliance concerns. We identified the following four problems which contributed to these weaknesses.

1. A centralized system to monitor and address environmental actions was not completed.

2. Managers and operating employees were not adequately trained.
3. Required environmental audits were not completed.
4. Day-to-day contract oversight was not accomplished in a manner to ensure that contract terms were appropriately enforced.

In summary, our Flash Report expressed our concern regarding the overall focus of actions the Department was taking in the environmental area. The report provided a series of recommendations for immediate corrective action. These included:

- o Establish a central data base for tracking hazardous materials at each facility, permits granted and pending, violations, and environmental training.
- o Standardize training curriculums on environmental matters.
- o Expedite action to perform environmental audit assessments.
- o Improve contractor performance by providing oversight of contractor compliance with environmental requirements.

- o Report and highlight environmental concerns as material weaknesses in the annual Federal Managers' Financial Integrity Act report.

Management has concurred in all recommendations made in the Flash Report and is in the process of implementing corrective actions. We are currently conducting indepth reviews of the issues highlighted in the Flash Report.

REPORT ON "REVIEW OF ENVIRONMENTAL SURVEY PROGRAM"

On July 14, 1989, the Office of Inspector General issued an audit report on the "Review of the Environmental Survey Program."

The purpose of this audit was to determine if the Department's environmental survey program--a 3-year, \$60 million effort--was performed in accordance with established criteria. The environmental surveys were designed to identify and prioritize environmental problems at the Department's operating facilities. The surveys were designed to provide the data to permit systematic decisions on the sequence in which DOE's environmental problems should be addressed. The audit found that working papers did not always meet established criteria and that management decisions were not always substantiated.

ONGOING AUDIT INITIATIVES

I would now like to describe for the Committee five other audit initiatives in process.

The first initiative is an audit of the testing laboratory support being provided to the DOE environmental survey sampling and analysis program. Our objective is to determine whether DOE laboratories performed required environmental sampling and analysis in accordance with prescribed procedures.

Secondly, we are evaluating the environmental assistance awards that have been and will be made to State governments in connection with recognized problems at DOE facilities. Our objective is to determine if the environmental assistance awards made to the States for oversight of DOE facilities contain the programmatic and administrative controls usually found in Federal award instruments such as grants and cooperative agreements.

Thirdly, we are auditing the Department's process for budgeting for environmental compliance projects. The objective is to determine whether the Department of Energy has adequately budgeted for environmental activities, particularly for cleanup activity specified in the compliance agreements that DOE has signed with the Environmental Protection Agency and the various States.

Our fourth initiative is an evaluation of the efforts underway to improve identification and tracking of environmental concerns. Specifically, we plan to determine whether existing systems in DOE are adequate for tracking RCRA requirements and whether DOE Headquarters and field sites can adequately demonstrate their degree of compliance with RCRA through existing tracking systems.

Finally, we are also reviewing the Department's initiatives to ensure that its personnel and contractor personnel are properly trained to assure compliance with environmental laws.

CONTINUING AUDIT COMMITMENT

I believe audit has a major role to play in uncovering DOE's problems and in making sound, reasonable recommendations for corrective action. To demonstrate the Office of Inspector General commitment to identify and help to remedy the problems the Department faces in the area of environment, safety, and health, I would like to point out that our audit program guidance for 1990 requires that about one-half of the discretionary available audit time be expended in this and related high-priority audit areas.

OIG's ENVIRONMENTAL INVESTIGATIVE EFFORTS

I would now like to discuss some of my office's efforts in investigating environmental matters. The investigative and enforcement process is an important tool in the effort to bring all DOE facilities into compliance with applicable environmental laws and regulations.

Currently, we have approximately 14 open investigations looking into various allegations of environmental wrongdoing. Included in these cases are joint efforts with the Environmental Protection Agency (EPA) and the Federal Bureau of Investigation (FBI) at Rocky Flats, West Valley, and Fernald. Because these are open cases, I am not at liberty to discuss details of these cases at this time.

The DOE OIG has been involved in the investigation of 27 environmental, health, and safety cases in the past; however, more needs to be done.

We are moving aggressively to enhance our ability to identify and pursue possible environmental crimes. We have, for example:

- o Added 24 investigative positions at DOE facilities around the country. This nearly doubles the number of case agents available to conduct investigations.

- o Initiated investigative environmental crime training.
- o Worked with the FBI and the EPA to assure access to the special expertise required to investigate environmental matters.

INDEMNIFICATION OF DOE'S MANAGEMENT AND OPERATING CONTRACTORS

Management and operating contractors run the Department's major facilities. These cost type M&O contracts account for about two-thirds of the Department's budget. My office recently released a report which examined the Department's policies and practices for indemnifying these M&O contractors.

The purpose of this report was to review the Department of Energy's policies and practices regarding both the nuclear and non-nuclear indemnification of its management and operating contractors. We found that the Department's fundamental policy is, with few exceptions, to completely indemnify its M&O contractors; bear substantially all risks, both nuclear and non-nuclear; and pay all costs associated with running its facilities. These costs include fines, penalties, claims, losses, and damages. In summary, virtually all costs incurred by M&O contractors can be expected to be paid under the contracts.

The major exceptions to total indemnification are: costs that have been specifically identified in the contract as unallowable; losses or expenses that result from the willful misconduct or lack of good faith on the part of a few, key contractor personnel; and fines and penalties on activities outside the scope of work or without contracting officer approval. The Department's indemnification of nuclear activities is required by the Price-Anderson Amendments Act of 1988, which also subjects the contractor to both civil and criminal penalties. Non-nuclear indemnification is permitted through general contract authority.

We found that, in the face of the Department's indemnification policies, the award fee mechanism constituted a very important financial incentive over the contractors' performance. The award fee is incorporated in 29 of the Department's 52 active M&O contracts. It is not used on 23 contracts which are fixed-fee or non-profit in nature. The Secretary has focused considerable personal attention to the award fee process. For example, he is increasing the impact of ES&H performance in the determination of award fees under the contracts.

We found that, although the Price-Anderson Amendments Act of 1988 provides for civil penalties against the contractors, existing language in the M&O contracts would appear to allow indemnification of the contractors from such penalties. We

recommended that the contracts be modified to resolve this apparent conflict.

Some of the M&O contractors are set up as independent corporations, separate from their parent corporations and without significant assets. We consequently recommended that DOE ascertain whether civil penalties could in fact be collected from such subsidiary corporations.

We noted that the administrative procedures necessary to implement a civil penalties program as authorized by the Price-Anderson Amendments Act of 1988 were not yet in place, and we recommended that this be done.

Looking at indemnification from a broader perspective, namely relieving corporate personnel from personal responsibility, we noted only one contract (no longer active) which provided DOE with the contractual right to demand removal of a contractor employee from DOE work. We also noted that the Department of Energy Acquisition Regulation (DEAR) clause on this subject used in the M&O contracts appeared to have erroneously omitted such a right of removal. We have recommended that such a right of removal be asserted in the M&O contracts.

We found that, in five of the Department's M&O contracts, reasonableness was not used as a definitive criterion in determining the allowability of costs. We recommended that the Department reconsider this situation.

Finally, although some DOE officials believed that the current indemnification policies and practices represents the least costly and most practical alternative available to the Department, we believe the Department should assess the merits of making some changes to the system. In particular, we recommended that the Department consider increasing the number of contractor personnel whose actions could result in corporate liability, and also consider identifying other circumstances, for example environmental fines and penalties, for which the contractor would be held financially responsible.

The number of corporate personnel whose actions could result in corporate liability under the current contracts is virtually limited to the top one or two contractor employees at a site as large as Savannah River. As an example, at that site, roof replacement contracts originally totaling over \$1.5 million were fraudulently awarded by a supervisor in DuPont's procurement office. This and subsequent fraudulent acts resulted in over \$3 million of unnecessary costs being paid by DOE, to include

\$420 thousand of stolen money and materials. Since the supervisor was not determined to be "managerial personnel" under the terms of the contract, these costs were allowable.

We have discussed DOE's current indemnification policies and practices with Departmental officials. Some DOE officials have expressed the belief that the Department's current policy of comprehensive indemnification represents the most practical alternative available to the Department. They believed that, if the Department did not fully indemnify its contractors, the risks to the contractors would be so great that the Department would be unable to find qualified contractors willing to run the Department's facilities. In addition, they believed that the fees currently paid to the Department's M&O contractors were very low and reflect in large measure the absence of substantial financial risk to the contractors.

Accordingly, these Department officials contended that any changes in this current indemnification policy that would increase the risk to the contractors would result in demands for greatly increased fees. In addition, they believed that the extent to which the contractors were not indemnified from loss by the Department would necessitate the contractors acquiring insurance coverage. Such insurance, if even available, would be, in their opinion, tremendously costly and would have to be borne by the Department as a cost of the contract.

However, after receiving the report, the Secretary stated in a memorandum to me on September 22, 1989, that as a result of the report, he has directed that the recommendations we made be reviewed for appropriate corrective action. Further, he has directed that this review be completed in 60 days.

DOE OVERSIGHT OF ALLOWABLE COSTS

The question of indemnification is closely related to DOE's oversight of allowable costs. I previously pointed out that the M&O contract concept and the way it is structured significantly impacts on the identification of unallowable costs. As a result, costs incurred by M&O contractors are infrequently disallowed. The M&O contract concept does not, therefore, lend itself to the typical voucher or cost incurred audit. This is because: (1) the identified list of unallowable costs in the M&O contract is limited in number and tightly drawn in scope, and (2) the books and records and the work done by the M&O's are separate and distinct from the firm's commercial work. Consequently, there is no cost distribution between the DOE and the non-DOE work.

However, two important mechanisms exist which provide for evaluating the allowability or reasonableness of costs incurred

by the Department's M&O contractors. The first of these mechanisms is the structure the Department established to administer each M&O contract. Let me point out that most of the M&O contracts are awarded by the Department's field Operations Offices with Headquarters review. An Operations Office official, frequently the manager of that office, serves as the contracting officer for the M&O contract. The full resources of the operations office, including specialists in such subjects as industrial relations, facilities management, and personal and real property, assist the contracting officer in administering the M&O contract. The contracting officers, with the assistance of these specialists, establish a set of internal controls, performance checks, and ongoing contract monitoring procedures to ensure, among other objectives, contractor compliance with allowable cost provisions in the contract. Thus, the primary responsibility for overall program and contract management control is maintained by the contracting officer and other elements of the Department.

The second mechanism for evaluating the reasonableness or allowability of M&O costs is the audit function within my office. We have concluded that the most effective strategy in this area is to try to: (1) identify and prevent M&O contractor expenditures which are not economic or efficient, and (2) to identify and recommend corrective actions for weaknesses in the Department's oversight activities which I have just described.

In the past 2 years, we have issued a number of reports that identified actions that management could take affecting over \$700 million in M&O contractor expenditures. For example:

- o In June 1987, we reported that, since 1979, the Department had reimbursed M&O contractors for contributions to employee pension plans in amounts that exceeded Government-established minimum funding requirements. The M&O contractors included in the review contributed \$222 million to employee pension plans during 1983. Contributions could have been reduced by an estimated \$94 million, or about 40 percent, had the plans been funded at the minimum required level.
- o In April 1988, we concluded that \$75 million in severance payments to be provided to DuPont employees offered employment with a successor contract would be unallowable under terms of the contract. The audit recommended that DuPont, the former M&O operator of the Department's Savannah River Plant, be notified immediately that the Department would not pay severance to such employees. Management agreed and quickly notified Du Pont of this position.
- o In July 1988, we reported that at least \$52,000 in improper charges should be recovered, since the M&O

contractors' management at the Department's Rocky Flats Plant knew the internal controls at the Plant were inadequate and did not take steps to correct them. These charges were for items (staircases, house plans, wine press, etc.) intended for personal use and for items for which no direct job orders were found. Another \$668,000 in charges for mementos, plaques, and medallions were made for other Department contractors. We questioned the appropriateness of these charges as well.

- o In October 1988, my office reported that an estimated \$481,000 could be saved annually by reducing the schedule of contractor flights between the Los Alamos National Laboratory and Albuquerque, New Mexico. We found that usage of the scheduled air transportation had decreased for the past 2 years and that less costly aircraft could be utilized to operate the air service.
- o In February 1989, an audit of the Du Pont pension fund showed that the fund, with Government-provided assets of \$1.165 billion as of June 30, 1987, was overfunded by about \$513 million. The report recommended that the Department promptly develop a negotiating strategy for settling the pension funding arrangements, including obtaining an independent actuarial assessment before a final Department position was established. These actions

would help ensure that the Department recoups all assets in the fund that are excess to valid requirements.

- o In February 1989, another OIG audit reported that the unique DuPont practice of prefunding "other-than-pension benefits" should be discontinued upon contract expiration and that any funds remaining in the prefunded account should be utilized. The amount in the prefunded account as of May 17, 1988, was about \$23 million.

Our work in this area is complemented by audit efforts undertaken by the U.S. General Accounting Office and by audits made by the internal auditors of the M&O contractors.

We have also established a cyclical audit approach to review the M&O contractors' financial accounting and other systems and activities. This includes reviews of internal control systems maintained by the M&O contractors and the Department's field elements. We believe this will provide additional assurance that the costs claimed by the M&O's and reimbursed by DOE are allowable under the contract.

CONCLUSION

Given the challenges facing the Department and the fact that virtually all costs incurred by M&O contractors can be expected

to be paid by the Department, we believe DOE must intensify its management and oversight over M&O contractor activities. In this regard, we have recently undertaken a separate series of reviews to assess the role of Operations Offices in the management of M&O contractors. The initial review, at the San Francisco Operations Office, will examine its responsibilities, authorities, staffing, and performance, particularly in relation to managing M&O contractors.

This concludes my testimony, and I would be happy to answer any questions that you might have.

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PRESENTED BY WITNESS

Statement of
Bill D. Colvin
Office of Inspector General
National Aeronautics and Space Administration
before the
Committee on Governmental Affairs
United States Senate

Mr. Chairman, members of the committee, thank you for the opportunity to appear before you today. I would like to take a few moments to share with you some of the background of the Office of Inspector General at the National Aeronautics and Space Administration, some of our accomplishments since 1985 when I was appointed as Inspector General, and the concerns I have today.

NASA is a large agency. We have over 22,000 civil service employees and an estimated 29,000 contractor employees that work on NASA projects. NASA's research and development activities are directed and managed from Headquarters and nine field centers around the country. This research and development work is largely executed by contractors. In Fiscal Year 1989, NASA's budget authority totaled approximately \$10.9 billion. The outstanding balance on current contracts issued by NASA exceeds \$31 billion.

The NASA Office of Inspector General was established by the Inspector General Act of 1978 to perform audits and investigations and to assist NASA management in promoting economy, efficiency, and effectiveness in the administration of its programs and operations, and to prevent and detect fraud and mismanagement. With over 88 percent of the Agency's total obligations allocated to procurement, a significant amount of our activity is directed toward contract fraud and procurement irregularities. OIG auditors and investigators conduct independent audits and investigations of NASA programs and operations. We also work jointly with other Offices of Inspector General, the Federal Bureau of Investigation, the Defense Contract Audit Agency and other audit and investigative entities when concurrent jurisdiction exists.

When I was appointed Inspector General at NASA, we had an authorized ceiling of 97 Full Time Equivalent positions. Our ceiling for 1989 is 136 positions. The staff now consists of 68 auditors, 37 investigators and 31 support and administrative positions. With this staff we issue about 35 audit reports and 200 reports of investigation per year. We

currently have about 70 audits and 300 investigations in process, with another 300 investigations identified and screened, but waiting to be worked.

This year our audits have resulted in about \$66 million in potential cost savings and recoveries, and opportunities for significant management improvements in NASA programs and operations. We also processed 118 DCAA reports identifying an additional \$21 million in financial recoveries. The investigative program produced over \$3.3 million in financial recoveries and identified about \$1.7 million in funds that management agreed to put to better use. Our investigations have also resulted in 20 indictments and 12 convictions. This represents a potential for financial recovery to NASA or the government of approximately \$91 million, the highest level of productivity in the history of the OIG. But this is only one measure of our productivity. Our audit of the aerospace fastener industry did not result in a reporting of financial savings, yet it is a most significant audit in terms of results. Other areas of particularly significant OIG activity have been quality assurance, subcontract management, contractor leasing of facilities, and contract mischarging.

Through effective audit and investigation programs, we have significantly improved the integrity in and management of NASA's programs and operations. This is particularly noteworthy in the aerospace fastener industry where investigations have resulted in several indictments, convictions, and fines; and where audits strengthened the certification procedures, culminating in testimony before Congress concerning new legislation in the fastener industry.

Audits of three NASA centers' subcontract management by prime NASA contractors found subcontractors were realizing excessive profits. In one instance, profits ranging from 28 to 288 percent were realized on 41 percent of the subcontracts reviewed. The audits also determined that the number of contracts awarded noncompetitively ranged from 63 to 86 percent. The OIG estimated that by increasing competition, future annual procurement costs could be reduced by about \$22 million. The OIG recommended that NASA recover \$17.9 million from the prime contractors for the excessive subcontractor profits. Recommendations were also made to improve subcontract management procedures to ensure more effective evaluation of subcontractors' proposed costs and to ensure increased subcontract competition. NASA management is continuing to implement corrective actions on the recommendations.

There are a number of areas where I have concerns. These include audit follow-up; internal controls; security; safety, reliability, maintainability and quality assurance; procurement and contract management; financial management;

commercialization of space; environmental issues; and third party financing.

Although I am proud of our accomplishments to date, we are able to only audit four percent of the total internal audit universe each year. This means we look at a given area about once every 22 years. If we limit our audits to only those of the highest priority, we are able to do about 11 percent per year or put another way, we look at the high priority areas about once every nine years. Due to the workload, our investigative cases are open an average of nearly one year from start to closing. In excess of 80 percent of these matters are criminal in nature. What all these numbers tell us is that many NASA programs will come and go without ever being reviewed and that investigations will not be as successful as they could be if they were more timely. These are all risks that must be decided in terms of what is acceptable to you the Congress and to NASA management.

We have invested considerable time and money into finding ways for us to do more with our limited resources. We are probably as automated as can reasonably be expected internally. We have looked at how we do our work and have attempted to become more efficient. We also work closely with the President's Council on Integrity and Efficiency (PCIE) to make use of techniques found to be successful by other OIG's as well as to participate in government-wide audit projects. I have served as cochairman of the PCIE Computer Committee and am active on the Audit Project subcommittee. Beginning this year I am a member of the National Institute of Standards and Technology's Computer System Security and Privacy Advisory Board.

I feel we have come a long way in meeting our goals and especially want to thank this committee for its invaluable support of our activities. This concludes my formal statement. I would be glad to answer any questions the committee may have.

STATEMENT OF

SHERMAN M. FUNK
INSPECTOR GENERAL
DEPARTMENT OF STATE

BEFORE THE

GOVERNMENTAL AFFAIRS COMMITTEE
UNITED STATES SENATE

SEPTEMBER 28, 1989

Mr. Chairman, I am pleased to appear here today to discuss a number of issues which concern me, both as Inspector General of the Department of State, and as Vice Chairman of the President's Council on Integrity and Efficiency.

First, the State issues. Some of these are deeply embedded in the structure and culture of the Department. Many involve other agencies operating overseas. All of them are thorny.

I will begin with visa and passport fraud. The Department turns out what are probably some of the most valuable documents in the world: visas to gain entry into the United States, and passports to demonstrate American citizenship. The going price for a visa ranges from four to perhaps ten thousand dollars a pop, more under special circumstances. There is no practical ceiling for passports; their price depends entirely on how desperate a person is to get one and how much money the individual has readily available. For example, one of my investigators operating under cover was flatly offered forty thousand dollars in cash for five passports.

In a way, it is flattering as an American to realize the value of admission to our country. As an IG, however, I am alarmed. For one thing, much of the work involved in processing visas overseas is handled by Foreign Service National employees in our embassies and consulates. These FSNs are paid on a scale tailored to the prevailing wages in their countries; often, this is quite low, which makes them particularly vulnerable to bribes and other gratuities. Last month, in Bangkok, we completed -- jointly with the Bureau of Diplomatic Security -- a long investigation, after which seven FSNs in the visa section of the embassy were dismissed, one suspended, and one reprimanded. But the problem is not limited to countries with a relatively low standard of living. Just two weeks ago, in Tel Aviv, we completed an even longer investigation of visa fraud, working together with Diplomatic Security and the Israeli National Police. This resulted in the arrest of six FSNs from the embassy and at least sixteen other arrests of Israeli citizens by the national police. And these are just two recent cases. We issued an audit report barely a month ago which called in some detail for tighter controls over

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visa equipment, improved coordination of information on anti-fraud activities overseas, and better use of current staff. The Department's formal response is not due yet, but we understand informally that our recommendations will be accepted and carried out.

When the IGs met with President Bush, a few days after his inauguration, he laid on us a charge to give a heads-up, an early warning, of problems in our agencies that might generate heavy spending downstream. He mentioned the savings and loan crisis and the deficiencies in our nuclear plants as examples, each of which will cost many billions to correct. He asked us to help avoid similar problems by early identification, so that an early fix would preclude huge expenditures later. State, of course, is essentially a people agency; we are not heavily funded compared to other Cabinet departments. Our budget is walking-around money for HHS or Defense. For that very reason, we can't afford to take a big hit. I thought of this as I left the White House that day, and one problem came immediately to mind: The repair and maintenance of our real property overseas.

State owns about 2100 properties abroad, and their average age is 22 years. Many critical components of these buildings are already past their economic life expectancy. Because of security and other considerations, the pressure until very recently has been pointed toward new construction and, as a result, far too little has gone into maintenance and repair. I believe that last year was the first time the Department really hollered about this situation up here on the Hill. I hope it is not too late. At the moment, short of money and staff I do not even see on the horizon, the future of this problem looks bleak. We plan to audit this area for the first time later in the current fiscal year.

Because of our new Office of Security Oversight I established last January at the direction of the Secretary of State, and the work we have done in this area since then, I am acutely aware of shortcomings in the security of our personnel, information, and facilities overseas. The good news is that the Department has made truly immense advances in this area during the past few years, advances that few would have thought possible in so brief a time span. The bad news is that we still have a far far piece to go. We must continue to focus, in concert with the intelligence agencies, on developing and implementing post-specific enforceable security standards for our facilities abroad, with a special emphasis on critical and high-threat posts.

I cannot go into details in an open hearing, but our Security Oversight inspection and audit teams continue to find critical vulnerabilities at our posts and in our security programs. Some of these result simply from a lack of resources to carry out security measures; adequate security, unfortunately, does not come on the cheap. But other

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vulnerabilities still remain as the heritage of past inertia, erroneous security perceptions by many employees, and a lack of stringent accountability for chiefs of mission responsible for safeguarding our personnel, information and facilities. In view of their sensitivity and impact, I personally brief senior management on our security inspection and audit reports. Difficult decisions have been made, and made quickly, requiring expenditure of scarce resources. I have every confidence that the picture is being turned around.

The next problem has a sharp impact on security. Simply put, we are supporting too many people overseas. And the more people to keep safe, the higher the security cost. Until 1986, there was virtually uncontrollable growth in the number of personnel from other agencies assigned to our embassies and consulates. In Frankfurt alone, which isn't even an embassy, I understand at last count that some 36 agencies are represented. It seems that almost every agency wants an overseas presence, despite an average cost per individual American employee of well over \$100,000 a year, plus salary. In many of our posts, State personnel account for less than a third of the total staffing.

Part of the reason for other agency growth is a self-inflicted wound: the Department does not yet have a good mechanism for collecting reimbursements for the cost of providing office space and other administrative support. As a result, other agencies receive freebies in the form of no rent and no communications charges. State, of course, being a charitable landlord, picks up the slack. I suspect that another reason for such growth can be found here at home. If an ambassador tries to downsize an embassy, he must come to the Department with specific reasons for every position he wants to eliminate. The Department then goes to each agency concerned for comment. And then the counter-pressure starts, not least because constituent groups promptly put the arm on everyone from the Hill to Foggy Bottom. And the ambassador is soon advised that the Department greatly admires his courage and tough cost-effective approach, but does he really want to tick off half the population inside the Beltway? And the problem continues to escalate, together with the rent for our properties abroad. We have addressed this area in many inspection reports, each containing specific recommendations. Normally, the Department agrees with our recommendations, but we of course have no way of getting directly at other agency staffing problems, although we have tried and struck out. We now have a major audit under way of our system for collecting reimbursements.

Two months ago, before the Senate Foreign Relations Subcommittee on Terrorism, Narcotics, and International Operations, I testified about an audit report we had issued on the Department's narcotics eradication and interdiction programs in Peru and Bolivia. I gave a gloomy assessment,

because we had found a host of problems, not least those involving the safety of our people coordinating operations there. It appears that most of the individual deficiencies I cited have since been corrected or are now being aggressively addressed. Nevertheless, in view of the difficulties we face, my gloom has not evaporated. It is much too early to gauge the results of our expanded narcotics effort in the Andean region, but we shall keep an eye on it. I will be releasing a classified audit report soon on our narcotics programs in the Golden Triangle of Southeast Asia. The situation there is better than in Latin America, but not by much. Our audit, which essentially questioned the status of the emperor's clothes, drew sharp and angry reaction from the then-bureau head, although she then agreed with almost all of our recommendations.

Within the past year, the State Department, for the first time, joined the Major Systems Acquisition Club. Our new telecommunications network, a mammoth computer buy, and a complex world-wide information system, are all in various stages of procurement. The Department has not fully geared up to the implications of such system acquisitions, nor indeed are any of these being managed as a true vertical system. As a result, for the two we have examined, we found that requirements were not adequately generated or validated, and that controls were not in place to assure effective management of cost, scheduling, and performance. Our audits on the telecommunications and information systems, after some initial shock, were greeted well by the Department, and most of their recommendations have been carried out.

One of the most contentious issues I have encountered at State arose from two duplicative and, in effect, competitive financial systems. Although each has some strengths (and hotly partisan supporters), they generally provide inadequate information for controlling the use of funds and making funding decisions, and inadequate accountability. Our very comprehensive audit of this whole area served to define the problem and set the stage for major changes in the Department's financial systems. Some of our recommendations may be rejected in the form in which we laid them out, but the basic thrust remains; the audit has achieved its purpose.

Finally, the Foreign Service personnel system continues to provide the Department with Foreign Service Officers of unusually high caliber and abilities, individuals who generally represent this country very well and, often, outstandingly. Yet, as several recent studies have asserted and we have found, problems in the system may soon outweigh its accomplishments. Many talented officers are forced out in their prime, posts too frequently lack an appropriate mix of talents, and long staffing gaps have become commonplace. The complex and

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cumbersome bidding process deprives the Department of critical skills in those assignments not regarded as career-enhancing, nor do enough people receive the training they need to properly perform their next jobs. The system places great pressure on FSOs not to make waves, lest they trigger corridor gossip which can unobtrusively torpedo careers. Nevertheless, this same system produces stars who rise to the top and who can more than hold their own with the most gifted leaders in government, industry, and the military.

We probably have had hundreds of inspection recommendations in the personnel area, the vast majority of which have been accepted; however, these usually addressed localized problems. We have yet to come to grips on the audit side with significant aspects of the personnel system -- except for an audit of the Senior Foreign Service Performance Awards, in which only a single recommendation remains unresolved.

My single most pleasant surprise at State has been the extraordinary responsiveness of the Department to our recommendations. Initially, I suspect that this stemmed in part from fear of the unknown. I came to State as the first IG who was not, and by law could not be, a Foreign Service Officer, and with a reputation -- which I was careful not to discourage -- for being a hard-liner. But that was two years ago, and the responsiveness is now better than before.

This may reflect the unique culture of State, which is quick to accept criticism, quicker to seek mutually agreeable solutions (the Department is, after all, a body of diplomats), and then stubbornly resistant to change, so that agreement by no means is always followed by implementation. To cut this resistance off at the pass, we have adopted a far-reaching compliance program. We not only track about 2500 recommendations at any one time by computer but, six to 15 months after an inspection, we send compliance followup review teams to 40 percent of the posts and bureaus inspected, to find out if the posts did what they said they would do. About a quarter of our audits are also followed up in detail, using a different method. Misstatements on compliance reports are grounds for disciplinary action.

The biggest factor in responsiveness, though, is our continued outstanding support from top management. Jim Baker and Larry Eagleburger, backed up by Ivan Selin, Under Secretary for Management, view my office as a central player in their plans for effecting change in the Department. As a result, many of our recommendations are now being accepted with disconcerting speed. On at least two occasions, when I sent recommendations directly to the senior level of the Department, copies returned the next morning with "Done" scrawled in the margin. Not "Accepted." Not "We'll do it." But "Done."

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Let me shift now and put on my PCIE hat.

There was considerable uneasiness in the IG community when months passed after the President's Inauguration and no word was given to the IGs about their status. I frankly think that much of this apprehension was not warranted; the entire appointment process experienced delays. In any case, Presidential Personnel knew, and advised the Acting Chairman of the PCIE early in March, that there would be no wholesale dismissal akin to January 20, 1981. This information was given to the PCIE members in March.

We were also told that the White House would be speaking to each Department head about retention of the incumbent IG. These calls, it was said, were to be phrased in such a manner as to make it very clear that the presumption would be the incumbent would be retained, unless there were specific and sound reasons to the contrary. Further, such reasons could not be partisan in nature.

If matters had moved quickly then, I doubt if there would have been such concern among the IGs. However, the process dragged on for many months before the IGs who were to be kept on received their package of forms from the White House. To the best of my knowledge, this package was the first formal notice to any of the IGs that he or she was to be retained by the President.

In my case, I was advised informally last January that Secretary Baker had asked that I stay, but the first "official" word I had that I had been reappointed was a short blurb in The Washington Post a few days ago. I suspect, however, that the IGs are not unique in the way our retention was handled. Several hold-overs from the Reagan Administration told me that they too felt as though they were walking back and forth through the looking-glass.

Is there a better way? I think so. Last year, in testimony before the House Government Operations Committee, I recommended a term appointment for the Presidentially-appointed IGs. I suggested seven years, because this would overlap quadrennial elections and thus assure greater independence. Also, I thought that seven years was long enough in one agency. Beyond that, there may be a question of becoming stale or jaded, neither of which is an appropriate adjective for an IG. Further, after seven years, you get to know the agency senior career staff so well there is a danger of unconscious co-option or, at least, undue familiarity.

I am much more concerned about filling IG vacancies than I am about the present reappointment process. In the latter case, there is at least an IG in position, able to act with the full powers of the office. When there is a prolonged vacancy,

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there is inherently a void, no matter how able and aggressive the Acting IG or Deputy IG. We have seen a steadily increasing time span between the departure of IGs and the appointment of their successors. VA has been vacant now for nearly two years. USDA was vacant for a considerable period. Neither Justice nor FEMA, so far as I know, is close to filling its slot. This is simply unacceptable.

As Vice Chair of the PCIE, I have become aware of problems encountered by the IGs, internal and external. One of the former, I believe, needs a legislative fix. When the IG Act of 1978 was being drafted, there was some discussion about whether to specifically authorize separate counsel for the IGs. It was decided that such a provision was unnecessary, in view of the broad appointment authority given to the IGs. Unfortunately, this has not prevented several departments from trying to block establishment of an IG Office of Counsel. A number of IGs have had very serious difficulty here, usually because the General Counsels of the departments do not like lawyers floating around beyond their control. At least one IG, after many months of effort, has not yet obtained his own counsel. This matter should be addressed in the next package of amendments to the IG Act.

Finally, a few words about the Office of Legal Counsel opinion on the investigative authorities of the Inspectors General. I believe this matter has been blown wildly out of proportion. None of the IGs, none of us, wants to pick a fight with the Justice Department. We could not operate any kind of criminal investigation program without the close and continuing support of the litigation divisions in Main Justice and the 94 U.S. Attorney offices around the country. Of course, that cuts two ways. It is safe to say that the USAs feel the same way; after all, we make thousands of cases for them.

Two weeks ago, Ed Dennis, the Acting Deputy Attorney General, sent me a letter in my capacity of PCIE Vice Chair. The latter stated that "there may be some confusion or misunderstanding over the meaning of the [OLC] opinion and its application." He went on to say that DOJ would be pleased to work with the IGs to clarify the situation.

This week, Frank Hodsoll, the Executive Associate Director of OMB, and I met with Bill Barr, the Assistant Attorney General for Legal Counsel, and one of his key staffers to develop just such a clarification. I think we are extremely close to a joint statement that should resolve most -- not all -- of the problem. As soon as we firm up our draft, I will circulate it among the IGs for comment. It is premature for me to discuss it here because it has not yet been vetted by my colleagues.

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I will say this: the paper will spell out a means of assuring that the IGs can fulfill our lawful obligation to identify the presence of fraud, waste and abuse in the regulatory programs of our departments as well as in all other programs and operations of our departments.

Mr. Chairman, I will be happy to answer any questions you may have.

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TESTIMONY
OF
RICHARD P. KUSSEROW
INSPECTOR GENERAL
DEPARTMENT OF HEALTH AND HUMAN SERVICES
BEFORE
THE COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
ON
MATERIAL WEAKNESSES WITHIN THE
DEPARTMENT OF HEALTH AND HUMAN SERVICES
OCTOBER 3, 1989

GOOD MORNING, I AM RICHARD P. KUSSEROW, INSPECTOR GENERAL OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES. I AM PLEASED TO HAVE THE OPPORTUNITY TO REPORT ON OUR DEPARTMENT'S PROGRESS IN IMPLEMENTING THE FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT (FMFIA). THE PURPOSE OF THE LEGISLATION IS TO INSURE THAT THE FEDERAL GOVERNMENT HAS IN PLACE PROPER CONTROLS AND FIXED RESPONSIBILITIES, IS IDENTIFYING MATERIAL WEAKNESSES AND FINALLY, HAS DESIGNED AND IMPLEMENTED CORRECTIVE ACTION PLANS WHERE NEEDED. I WOULD FIRST LIKE TO PROVIDE SOME BACKGROUND ON THIS ACT.

BACKGROUND

THE FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT, P.L.97-255, WAS ENACTED IN 1982 TO ENHANCE THE FEDERAL GOVERNMENT'S PROCEDURES FOR MAINTAINING ACCOUNTING SYSTEMS AND INTERNAL CONTROLS OVER ITS RESOURCES. THE ACT MANDATES MANAGERS TO ESTABLISH A CONTINUOUS CHECK AND BALANCE PROCESS FOR EVALUATING, IMPROVING AND REPORTING ON THE INTERNAL CONTROLS AND ACCOUNTING SYSTEMS FOR WHICH THEY ARE RESPONSIBLE, THEREBY, CLOSING THOSE LOOPHOLES WHICH OFTEN LEAD TO FRAUD, WASTE, AND ABUSE WITHIN A DEPARTMENT OR AGENCY.

MORE SPECIFICALLY, THE ACT REQUIRES THAT A DEPARTMENT'S OR AGENCY'S INTERNAL CONTROL SYSTEMS BE EVALUATED, BY MANAGEMENT, TO DETERMINE IF THEY MEET THREE OBJECTIVES:

- OBLIGATIONS AND COSTS ARE IN COMPLIANCE WITH APPLICABLE LAW;
- FUNDS, PROPERTIES AND OTHER ASSETS ARE SAFEGUARDED AGAINST WASTE, LOSS, UNAUTHORIZED USE, OR MISAPPROPRIATION; AND,
- REVENUES AND EXPENDITURES APPLICABLE TO AGENCY OPERATIONS ARE PROPERLY RECORDED AND ACCOUNTED FOR, TO PERMIT THE PREPARATION OF ACCOUNTS AND RELIABLE FINANCIAL AND STATISTICAL REPORTS, AND TO MAINTAIN ACCOUNTABILITY OVER ASSETS.

THE OFFICE OF MANAGEMENT AND BUDGET (OMB) CIRCULAR A-123 PRESCRIBES POLICIES, GUIDELINES AND OBJECTIVES FOR MANAGERS IN ESTABLISHING, MAINTAINING, EVALUATING, IMPROVING AND REPORTING ON INTERNAL CONTROLS IN FEDERAL PROGRAMS AND ADMINISTRATIVE ACTIVITIES.

SINCE ENACTMENT, OUR OFFICE HAS WORKED CLOSELY WITH THE DEPARTMENT'S ASSISTANT SECRETARY FOR MANAGEMENT AND BUDGET (ASMB), WHO IS THE DEPARTMENT'S DESIGNATED INTERNAL CONTROL MANAGER. ALTHOUGH THE IG'S ROLE IS NOT

CLEARLY SPECIFIED IN THE STATUTE OR OMB CIRCULARS, WE ARE ACTIVELY INVOLVED BECAUSE WE VIEW EFFECTIVE INTERNAL CONTROL SYSTEMS AS THE PRIMARY MECHANISM FOR PREVENTING OR DETECTING FRAUD, ABUSE AND WASTE. THE ROLE WE HAVE ASSUMED IN THE FMFIA PROGRAM INCLUDES:

- PROVIDING TECHNICAL ADVICE AS A MEMBER OF THE DEPARTMENT'S STEERING COMMITTEE WHICH IS THE FOCAL POINT FOR POLICIES AND PRACTICES WITHIN THE DEPARTMENT FOR FMFIA ACTIVITIES;
- IDENTIFYING MATERIAL WEAKNESSES IN INTERNAL CONTROLS OR MATERIAL NON-CONFORMANCES IN ACCOUNTING SYSTEMS AS AN INTEGRAL STEP IN OUR REVIEWS OF DEPARTMENT ACTIVITIES;
- ADVISING TOP MANAGEMENT ON INTERNAL CONTROL ISSUES;
- TESTING THE DEPARTMENT'S PROCESS FOR EVALUATING INTERNAL CONTROLS,
- REVIEWING THE DEPARTMENT'S FMFIA ANNUAL REPORT TO THE PRESIDENT AND THE CONGRESS ON THE STATUS OF INTERNAL CONTROLS, AND

- MONITORING THE IMPLEMENTATION AND COMPLIANCE OF THE FMFIA PROGRAM.

DEPARTMENTAL INITIATIVES

BEFORE DISCUSSING OUR EXAMPLES, I WOULD LIKE TO TAKE A FEW MOMENTS TO DESCRIBE THE PROGRESS MADE-TO-DATE REGARDING FMFIA. WE WERE PLEASED THAT FORMER SECRETARY BOWEN WAS ABLE TO REPORT IN HIS LETTER TO THE PRESIDENT THAT 245 OF THE 265 MATERIAL WEAKNESSES IDENTIFIED TO DATE HAD BEEN CORRECTED AND CORRECTIVE ACTION PLANS HAD BEEN DEVELOPED FOR THE OTHERS. ONLY 11 MATERIAL WEAKNESSES ARE CURRENTLY UNRESOLVED. THE ASMB AND OIG HAVE A FOLLOW -UP PLAN TO CONTINUE MONITORING THESE REMAINING CORRECTIVE ACTION PLANS TO ENSURE TIMELY RESOLUTIONS. WE WILL FURTHER CONTINUE TESTING COMPLETED PLANS TO INSURE THAT THE PROGRAM MANAGERS HAVE INDEED FULLY COMPLIED WITH THEIR AGREED-TO SOLUTIONS TO THEIR INTERNAL CONTROL PROBLEMS. I AM ALSO PLEASED TO REPORT THAT THE DEPARTMENT HAS BEEN QUITE DILIGENT IN ACTING ON OUR RECOMMENDATIONS TO INSTITUTE MANAGEMENT CONTROLS WHERE THE DEPARTMENT OR THE OIG HAVE DISCOVERED MATERIAL WEAKNESSES.

SINCE ENACTMENT OF THE ACT IN 1982, THE DEPARTMENT HAS:

- DEVELOPED AND IMPLEMENTED A DEPARTMENT-WIDE FMFIA PROGRAM TO COMBAT FRAUD, WASTE AND ABUSE;
- PROMULGATED POLICIES AND PROCEDURES;
- ISSUED AND IMPLEMENTED A SECRETARIAL DIRECTIVE ESTABLISHING RESPONSIBILITIES AND DELEGATIONS OF AUTHORITY FOR DESIGNING, OVERSEEING AND OPERATING THE FMFIA PROGRAM;
- ESTABLISHED AN FMFIA STEERING COMMITTEE OF DIVISION MANAGERS, SECRETARIAL REPRESENTATIVES, AND OIG AUDITORS TO ADVISE THE OFFICE OF THE SECRETARY ON THE MOST EFFECTIVE MANNER OF MEETING THE ACT'S OBJECTIVES;
- DIRECTED THAT MANAGERS BE HELD ACCOUNTABLE FOR THEIR FMFIA RESPONSIBILITIES THROUGH THE PERFORMANCE APPRAISAL PROCESS; AND
- CONDUCTED VULNERABILITY/RISK ASSESSMENTS OF INTERNAL CONTROL AREAS AND DEVELOPED AND IMPLEMENTED A MULTI-YEAR PLAN FOR CONDUCTING INTERNAL CONTROL REVIEWS.

THE DEPARTMENT IS ALSO IMPROVING ITS SYSTEM FOR FOLLOWING UP ON OIG RECOMMENDATIONS TO WHICH MANAGEMENT HAS AGREED IN ORDER TO ENSURE IMPLEMENTATION. THE

DEPARTMENT HAS NOT HAD A CENTRALIZED SYSTEM TO TRACK THE ACTUAL IMPLEMENTATION OF OIG RECOMMENDATIONS. UNDER THE LEADERSHIP OF SECRETARY SULLIVAN, THE DEPARTMENT APPEARS TO BE TURNING THE CORNER ON THIS PROBLEM. THE ASMB HAS BEEN WORKING WITH OIG STAFF TO ESTABLISH A DEPARTMENT-WIDE SYSTEM WHICH INCLUDES ADEQUATE INFORMATION ON THE IMPLEMENTATION OF OIG RECOMMENDATIONS.

THE ASMB, IN CONJUNCTION WITH THE OIG, ESTABLISHED A MANAGEMENT OVERSIGHT PROCESS TO REVIEW THE PROGRAMS AND ACTIVITIES OF DEPARTMENTAL COMPONENTS WITH RESPECT TO THE FMFIA AND AUDIT FOLLOW-UP. RECENT MEETINGS BETWEEN OUR OFFICE AND THE ASMB HAVE RESULTED IN STRENGTHENED ASMB CONTROLS TO MONITOR THE IMPLEMENTATION OF OIG RECOMMENDATIONS INCLUDING PERIODIC RECONCILIATIONS OF ACCOUNTS RECEIVABLE THAT RESULTED FROM DISALLOWED COSTS IN OIG REPORTS.

THE OIG IS ALSO EXPANDING ITS MANAGEMENT INFORMATION SYSTEM TO INCLUDE INFORMATION ON THE IMPLEMENTATION OF ALL OIG RECOMMENDATIONS AND WILL REPORT THIS INFORMATION TO THE ASMB TO ASSIST THEM IN THEIR MANDATED MONITORING, REPORTING AND FOLLOW-UP RESPONSIBILITIES. IN ADDITION, WE ARE INCREASING THE NUMBER OF FOLLOW-UP AUDITS CONDUCTED EACH YEAR AND ARE WORKING WITH THE ASMB IN TARGETING CRITICAL ISSUES FOR AUDIT FOLLOW-UP.

AS ALLUDED TO ABOVE, SECRETARY SULLIVAN HAS INSTITUTED AN INNOVATIVE PROCESS TO IMPROVE AND MAINTAIN ADHERENCE TO BOTH THE LETTER AND SPIRIT OF THE LAW BY ESTABLISHING THE COUNCIL OF MANAGEMENT OVERSIGHT TO INSURE TOP MANAGEMENT INVOLVEMENT IN THE INTEGRITY OF THE FMFIA AND AUDIT FOLLOW-UP PROGRAMS. THE COUNCIL IS CHAIRED BY THE DEPUTY ASSISTANT SECRETARY FOR FINANCE. OTHER MEMBERS INCLUDE THE DEPARTMENT'S AUDIT DIRECTOR (THE ASSISTANT INSPECTOR GENERAL FOR AUDIT) AND THE DEPUTY ASSISTANT SECRETARY FOR BUDGET. AS IMPLEMENTED, THE COUNCIL HOLDS HEARINGS FOR ALL OF THE DEPARTMENT'S OPERATING AND STAFF DIVISIONS, REQUIRING EACH DIVISION TO DEMONSTRATE HOW THEY ARE IMPLEMENTING THEIR FMFIA PROGRAM. SENIOR REPRESENTATIVES FROM THE DIVISIONS DESCRIBE THE NATURE AND RESULTS OF THEIR PROGRAMS, MANAGEMENT CONTROL PLAN PROGRESS AND INTERNAL CONTROL REVIEWS, INCLUDING THE IDENTIFICATION OF MATERIAL WEAKNESSES AND THE PROPOSED ACTION PLANS TO CORRECT WEAKNESSES. WE BELIEVE THAT THE REACTION TO THIS COUNCIL IS A GREAT STEP TOWARD SURFACING WEAKNESSES IN A TIMELY MANNER AND OBTAINING TOP MANAGEMENT ATTENTION AND COMMITMENT IN CORRECTING PROBLEMS.

HOWEVER, WE DO NOT WANT TO LEAVE YOU WITH THE IMPRESSION THAT ALL IS WELL IN OUR DEPARTMENT. BEFORE MAKING OUR RECOMMENDATIONS FOR IMPROVING THE FMFIA, WE WOULD LIKE TO POINT OUT THAT PROGRAM MANAGERS HAVE NOT IDENTIFIED

ANY NEW MATERIAL WEAKNESSES ON THEIR OWN DURING THE FY 1989 REPORTING PERIOD. THIS HAS BEEN THE PREVAILING TREND OF THE LAST FEW YEARS.

WE ARE CONCERNED THAT OUR AUDITORS ARE THE PRIMARY RESOURCE IN THE IDENTIFICATION OF MATERIAL WEAKNESSES. THIS IS CLEARLY INCONSISTENT WITH THE ORIGINAL INTENT OF THE ACT. THE ACT INTENDED THAT THE IDENTIFICATION OF MATERIAL WEAKNESSES WOULD ARISE FROM INTERNAL CONTROL REVIEWS PERFORMED BY PROGRAM MANAGERS NOT AUDITORS. THE ROLE OF THE AUDITOR WAS TO HELP INSURE THE INTEGRITY OF THE MANAGEMENT PROCESS. WHAT OUR DATA IS SHOWING IS THE REVERSE OF WHAT CONGRESS INTENDED. IT IS DIFFICULT FOR US TO BELIEVE THAT OF THE NEARLY 1000 INTERNAL CONTROL REVIEWS PERFORMED IN THE DEPARTMENT DURING THE PAST YEAR, NO MATERIAL WEAKNESSES WERE IDENTIFIED BY PROGRAM MANAGERS IN THE FIVE OPERATING DIVISIONS OF THE DEPARTMENT. IN FACT, THE ONLY MATERIAL WEAKNESS NOT IDENTIFIED AND REPORTED BY AUDITORS WAS BY THE NEW ASSISTANT SECRETARY FOR MANAGEMENT AND BUDGET IN HIS OWN SHOP. IT IS INCONCEIVABLE THAT SO MANY INTERNAL CONTROL REVIEWS COULD BE CONDUCTED BY PROGRAM MANAGEMENT WITHOUT THE IDENTIFICATION OF MANY MATERIAL WEAKNESSES.

FOR EXAMPLE, OVER THE LAST 3 YEARS 1987-1989 SOCIAL SECURITY ADMINISTRATION (SSA), A PROGRAM EMPLOYING 68,000

INDIVIDUALS, HANDLING \$236 BILLION PROGRAM BENEFITS FOR APPROXIMATELY 40 MILLION BENEFICIARIES, HAS NOT BEEN ABLE TO IDENTIFY A SINGLE MATERIAL WEAKNESS. AT THE SAME TIME THE OIG HAS HAD NO DIFFICULTY IDENTIFYING THEM.

SIMILARLY NEARLY 12 PERCENT OF THE OUTLAYS OF THE FEDERAL GOVERNMENT COME FROM THE HEALTH CARE FINANCING ADMINISTRATION (HCFA) WHICH ADMINISTERS MEDICARE AND MEDICAID. THESE ARE PROGRAMS WHICH ARE RESPONSIBLE FOR MINISTERING TO HEALTH NEEDS OF 57 MILLION PEOPLE INCLUDING ELDERLY, INFIRMED AND DISADVANTAGED AMERICANS. IN THE LAST 3 YEARS THEY HAVE BEEN ABLE TO IDENTIFY ONLY ONE MATERIAL WEAKNESS ON THEIR OWN. YET, OUR PEOPLE WORKING INDEPENDENTLY HAVE IDENTIFIED EIGHT MATERIAL WEAKNESSES THIS YEAR.

THE PATTERN HOLDS TRUE THROUGHOUT MUCH OF THE DEPARTMENT. FOR EXAMPLE, PROGRAM MANAGERS AT THE FOOD AND DRUG ADMINISTRATION (FDA) AND THE INDIAN HEALTH SERVICE (IHS) HAVE FAILED TO EMPLOY THE FMFIA IN MANY OF THEIR MAJOR PROGRAM OPERATIONS. IT IS THEREFORE NOT SURPRISING THAT OUR OFFICE ENCOUNTERED THE KIND OF PROBLEMS MENTIONED BELOW.

THE FOCUS OF IMPLEMENTATION HAS SHIFTED AS A RESULT OF OUR AUDIT COMMUNITY BEING THE PRIMARY SOURCE FOR THE IDENTIFICATION OF MATERIAL WEAKNESSES. PROGRAM

MANAGERS FIND THEMSELVES IN A DEFENSIVE MODE, ARGUING WHY THE WEAKNESSES IDENTIFIED BY AUDITORS ARE NOT MATERIAL, RATHER THAN EXPLAINING WHAT THEY SHOULD BE DOING ABOUT IT OR WHY THEY HAVE FAILED TO IDENTIFY THEM ON THEIR OWN. THIS SHIFTS THE FOCUS AWAY FROM BEING A COOPERATIVE SELF HELP PROCESS BY MANAGEMENT TO AN ADVERSARY ARRANGEMENT PITTING PROGRAM MANAGERS AGAINST THE OIG.

THERE CONTINUES TO BE CONSIDERABLE CONFUSION REGARDING THE APPLICABILITY OF THE LEGISLATION. MANY PROGRAM MANAGERS APPARENTLY DO NOT REALIZE THE FULL EXTENT AND COVERAGE OF THE FMFIA PROGRAM. THEY ERRONEOUSLY BELIEVE THAT IT ONLY REQUIRES EVALUATION TO ENSURE THAT INTERNAL CONTROLS OVER ACCOUNTING AND ADMINISTRATION FUNCTIONS ARE ADEQUATE. THE PROGRAMMATIC AREAS, WHERE PROBABLY 85 TO 90 PERCENT OF THE FEDERAL FUNDS ARE EXPENDED ARE OFTEN OMITTED FROM CLOSE SCRUTINY. ALSO THERE CONTINUES TO BE A NEED TO FURTHER CLARIFY THE DEFINITION OF WHAT IS A MATERIAL WEAKNESS. IT IS OUR UNDERSTANDING THAT OMB IS WORKING ON THIS PROBLEM. FOR PURPOSE OF DETERMINING WHAT CONSTITUTES A MATERIAL WEAKNESS IN INTERNAL CONTROL SYSTEMS THE CRITERIA SET FORTH IN THE OMB CIRCULAR A-123 ARE USED. THE CRITERIA PROVIDES FOR REPORTING AS MATERIAL WEAKNESSES, MATTERS THAT:

- SIGNIFICANTLY IMPAIR THE FULFILLMENT OF AN AGENCY OR COMPONENT'S MISSION;
- DEPRIVE THE PUBLIC OF NEEDED SERVICES;
- VIOLATE STATUTORY OR REGULATORY REQUIREMENTS;
- SIGNIFICANTLY WEAKEN SAFEGUARDS AGAINST WASTE, LOSS, UNAUTHORIZED USE OR MISAPPROPRIATION OF FUNDS, PROPERTY, OR OTHER ASSETS; OR
- RESULT IN A CONFLICT OF INTEREST

USING THOSE CRITERIA AS LATER AMPLIFIED BY OMB, WE HAVE IDENTIFIED SIGNIFICANT MATERIAL WEAKNESSES.

CASE EXAMPLES

LET ME PROVIDE YOU WITH SEVERAL CASE EXAMPLES OF MATERIAL WEAKNESSES WE HAVE UNCOVERED WITHIN THE DEPARTMENT.

(1) **POINT OF SALE (POS) SYSTEM FOR THE NEW MEDICARE DRUG BENEFIT:** THE MEDICARE CATASTROPHIC COVERAGE ACT OF 1988 (MCCA) REQUIRES THE SECRETARY TO ESTABLISH BY 1991, AN ELECTRONIC POINT-OF-SALE (POS) SYSTEM FOR USE BY PARTICIPATING PHARMACIES AND OTHER DRUG DISPENSERS IN

ADMINISTERING THE OUTPATIENT PRESCRIPTION DRUG BENEFIT. WITHIN THE DEPARTMENT, THE HEALTH CARE FINANCING ADMINISTRATION (HCFA) IS RESPONSIBLE FOR IMPLEMENTING THE REQUIREMENTS OF MCCA, INCLUDING THE POS SYSTEM, AND HAS ASSIGNED PERSONNEL TO MANAGE AND EXECUTE IMPLEMENTATION.

THE POS SYSTEM IS ONE OF THE MOST COSTLY AND TECHNICALLY COMPLEX PROCUREMENTS EVER ISSUED BY HCFA. THE CONGRESSIONAL BUDGET OFFICE HAS ESTIMATED THIS SYSTEM COULD COST \$500 MILLION TO DEVELOP AND OPERATE FOR FY 1991. IT IS ALSO ESTIMATED THAT COSTS COULD GO EXCEEDINGLY HIGHER IN FUTURE YEARS. THIS DRUG CLAIMS PROCESSING SYSTEM WILL OPERATE IN A SPECIALIZED HIGHLY AUTOMATED ENVIRONMENT INVOLVING SOPHISTICATED TELECOMMUNICATIONS AND BILL REVIEW SYSTEMS. THE THREE DRUG PROCESSORS SELECTED WILL BE RESPONSIBLE FOR A RANGE OF FUNCTIONS INCLUDING ENROLLMENT AND EDUCATION OF AN ESTIMATED 100,000 DISPENSERS, DRUG BILL PROCESSING OF AN ESTIMATED 700 MILLION CLAIMS, ESTABLISHING A NATIONAL TELECOMMUNICATIONS NETWORK TO SUPPORT POS TERMINALS, AND ON-LINE TRANSACTION PROCESSING, PHARMACY AUDIT, DRUG UTILIZATION REVIEW, AND DRUG DATABASE SUPPORT. THE DRUG BILL PROCESSOR MUST ALSO HAVE THE CAPABILITY TO PROCESS PAPER CLAIMS SUBMITTED BY MEDICARE'S 34 MILLION BENEFICIARIES.

OIG AUDITED THE TECHNICAL ASPECTS OF POS PROCUREMENT AND A COPY OF OUR REPORT IS BEING MADE AVAILABLE TO THE COMMITTEE. BASICALLY, WE HAVE SERIOUS CONCERNS OVER THE ACQUISITION PROCESS AND HCFA'S ABILITY TO IMPLIMENT THE POS SYSTEM IN A TIMELY AND EFFECTIVE MANNER. OUR CONCERNS ARE IN THE FOLOWING AREAS:

- DESIGN APPROACH AND LEVEL OF SYSTEMS INTEGRATION FOR THE SYSTEM;
- CONTROLS ON GOVERNMENT FUNDED TELECOMMUNICATIONS COSTS, AND
- THE TIGHT SCHEDULE FOR SYSTEM ACQUISITION AND IMPLEMENTATION.

IF IMPLEMENTED, WE DO NOT BELIEVE THAT THE PLANNED SYSTEM WILL WORK AS DESIGNED. IF THE SYSTEM FAILS TO OPERATE BY THE JANUARY 1, 1991 DATE, MILLIONS OF PAPER DRUG CLAIMS WILL HAVE TO BE PROCESSED BY THE REGULAR MEDICARE CARRIERS' WHICH WOULD RESULT IN SIGNIFICANT ADDED COSTS TO MEDICARE.

ON SEPTEMBER 18, 1989, WE ISSUED A MANAGEMENT ADVISORY REPORT ON PART OF THE HCFA'S FORTHCOMING COMPUTER PROCUREMENT PROGRAM. WE CONCLUDED THAT HCFA DOES NOT HAVE AN ADEQUATE SYSTEM OF INTERNAL CONTROLS TO

PROPERLY CONDUCT THE MULTI-MILLION DOLLAR POS PROCUREMENT. BOTH THE CONTRACT ACQUISITION AND PROGRAM MANAGEMENT FUNCTIONS FOR THE POS SYSTEM ARE ASSIGNED TO THE SAME COMPONENT, THE BUREAU OF PROGRAM OPERATIONS (BPO) WITHIN HCFA, VIOLATING THE MOST BASIC OF INTERNAL CONTROLS - SEPARATION OF DUTIES.

THE BPO OFFICIALS RESPONSIBLE FOR THE POS PROCUREMENT ARE CONSIDERED CONTRACTING OFFICERS BY VIRTUE OF THEIR POSITIONS. THEY DO NOT HAVE THE COMBINED ACQUISITION TRAINING AND EXPERIENCE TO BE CERTIFIED, SELECTED, AND APPOINTED CONTRACTING OFFICERS, WHICH WE BELIEVE IS NECESSARY FOR THE POS PROCUREMENT.

WE BELIEVE EFFECTIVE INTERNAL CONTROLS ARE ESSENTIAL TO ASSURE THE INTEGRITY OF THIS COMPETITIVE PROCUREMENT AND THAT THE PROCUREMENT IS HANDLED IN STRICT COMPLIANCE WITH APPLICABLE PROCUREMENT REGULATIONS. IN MOST FEDERAL AGENCIES THE CONTRACT ACQUISITION FUNCTION IS PERFORMED BY A CONTRACTING OFFICER IN AN ORGANIZATION THAT IS SEPARATE AND DISTINCT FROM THE PROGRAM MANAGERS. THE SEPARATION OF THESE DUTIES INSTITUTIONALIZES CHECKS AND BALANCES THROUGH THE ORGANIZATIONAL STRUCTURE. FOR THE POS PROCUREMENT THE HCFA PROGRAM MANAGER IS ALSO THE CONTRACTING OFFICER. THIS ARRANGEMENT DOES NOT ESTABLISH BASIC INTERNAL CONTROLS. WE BELIEVE A MATERIAL INTERNAL CONTROL WEAKNESS EXISTS BECAUSE OF THE ABSENCE

OF SEPARATION OF DUTIES, WHICH IF INCLUDED, WOULD ORGANIZATIONALLY PROVIDE CHECKS AND BALANCES AGAINST ERROR, WASTE OR FRAUD. A RESPONSE FROM HCFA IS DUE OCTOBER 18, 1989.

(2)OVERSIGHT OF GENERIC DRUG APPROVAL PROCESS: THE DRUG PRICE COMPETITION AND PATENT TERM RESTORATION ACT OF 1984 (P.L.98-417, DATED SEPTEMBER 24, 1984) AUTHORIZES FDA TO ACCEPT ABBREVIATED NEW DRUG APPLICATIONS (ANDAs) FOR GENERIC VERSIONS OF NEW BRAND NAME DRUG PRODUCTS FIRST APPROVED BY FDA FOR SAFETY AND EFFECTIVENESS AFTER 1962. BEFORE PASSAGE OF THE ACT, ANDAs WERE PERMITTED FOR GENERIC VERSIONS OF ONLY DRUG PRODUCTS APPROVED BETWEEN 1938 AND 1962. GENERIC DRUGS, TO BE APPROVED FOR MARKETING BY FDA, MUST BE THERAPEUTICALLY EQUIVALENT TO BRAND NAME DRUGS ALREADY APPROVED BY FDA AS SAFE AND EFFECTIVE. UNDER THE ACT, A MANUFACTURER MUST SHOW THAT ITS PRODUCT IS BIOEQUIVALENT--THAT THE ACTIVE INGREDIENT IS ABSORBED INTO THE HUMAN BODY AT ABOUT THE SAME RATE AND EXTENT AS THAT OF THE INNOVATOR OR BRAND NAME PRODUCT. GENERIC DRUGS ARE A MULTI-BILLION DOLLAR INDUSTRY IN THE UNITED STATES TODAY.

IN 1988, WE BEGAN A SERIES OF INVESTIGATIONS INTO ALLEGATIONS THAT EMPLOYEES IN THE FDA'S GENERIC DRUG DIVISION WERE RECEIVING PAYOFFS FROM GENERIC DRUG MANUFACTURERS TO ALTER THE GENERIC DRUG APPROVAL

PROCESS. AS OF AUGUST 1989, THREE FDA EMPLOYEES, THREE DRUG COMPANY EMPLOYEES AND TWO COMPANIES HAVE PLEADED GUILTY TO CONSPIRACY, AND INVESTIGATIONS ARE CONTINUING.

OUR AUDIT WORK IN THIS AREA INDICATED THAT INADEQUATE FDA CONTROLS OVER THE APPROVAL PROCESS FOR GENERIC DRUGS HAVE RESULTED IN REDUCED PUBLIC CONFIDENCE IN THE FAIRNESS AND EFFECTIVENESS OF FDA DRUG CERTIFICATION AND TESTING. OUR RECENT REPORT DISCLOSED THAT CERTAIN DRUG APPLICATIONS WERE ASSIGNED AND REASSIGNED TO REVIEWERS WITH THE INTENT OF EXPEDITING OR SLOWING THE DRUG APPROVAL. OUR WORK SHOWED THAT FDA MANAGEMENT HAD NOT ISSUED INTERNAL GUIDELINES TO INSURE CONSISTENT REVIEW OF APPLICATIONS AND A QUALITY CONTROL SYSTEM DID NOT EXIST. THIS SITUATION IMPAIRED ASSURANCE OF A FAIR REVIEW PROCESS, ALLOWED VIOLATION OF EMPLOYEE STANDARDS OF CONDUCT AND POSSIBLY DEPRIVED SOME DRUG FIRMS OF EARLY ACCESS TO THE MARKET AND HAS THE POTENTIAL TO IMPACT ADVERSELY ON THE HEALTH CARE OF THE AMERICAN PUBLIC. WE FOUND THAT ONLY ONE INTERNAL CONTROL REVIEW HAD BEEN PERFORMED REGARDING THESE APPLICATION PROCESSES.

(3)MANAGEMENT OF THE INDIAN HEALTH SERVICE: THE DEPARTMENT'S OIG IS CONDUCTING OVER 20 INVESTIGATIONS INTO THEFT AND PROGRAM MISMANAGEMENT IN THE IHS. FURTHER, WE HAVE FOUND THAT NO FMFIA INTERNAL CONTROL REVIEWS HAVE BEEN PERFORMED BY PROGRAM MANAGERS RELATED TO THE

INDIAN HEALTH SERVICE'S PRIMARY MISSION--THAT OF DELIVERING HEALTH SERVICES. HEALTH DELIVERY SERVICES ACCOUNT FOR 85 PERCENT OF THE IHS BUDGET OF \$1.1 BILLION IN FY 1989. IN ADDITION, DURING THE YEAR, THE IG HAS FOUND THAT (1) CONTROLS OVER IHS ACCOUNTING SYSTEMS ARE INADEQUATE TO ASSURE USEFUL, ACCURATE DATA IS PROVIDED TO MANAGERS (FOR EXAMPLE, THE OIG FOUND THAT SOME COSTS APPLICABLE TO THE OPERATION OF TWO IHS HOSPITALS WERE INAPPROPRIATELY BEING CHARGED TO AN IHS AREA OFFICE WHICH DISTORTS MEANINGFUL COST COMPARISONS OF HEALTH CARE); (2) WHAT THE OIG BELIEVES TO BE A MATERIAL WEAKNESS IS LEADING TO OVER-CONSTRUCTION AT TWO MAJOR IHS MEDICAL FACILITIES REPRESENTING OVER \$21 MILLION IN UNNECESSARY COSTS; AND (3) A MATERIAL INTERNAL CONTROL WEAKNESS HAS CONTRIBUTED TO FRAUD AND ABUSE IN THE AREA OF EMPLOYEE TRAVEL.

IN ADDITION, IHS AS YET, HAS INSUFFICIENT DOCUMENTATION TO SHOW THAT IT HAS CORRECTED MATERIAL WEAKNESSES IDENTIFIED IN THE DEPARTMENT'S 1988 FMFIA REPORT AND SCHEDULED FOR CORRECTION DURING 1989. THESE INCLUDE:

- NO CENTRALIZED CONTROL SYSTEM IN IHS FOR CONTROLLED SUBSTANCES (SCHEDULE II DRUGS) WITH A HIGH ABUSE POTENTIAL AS WELL AS A HIGH POTENTIAL FOR PSYCHOLOGICAL OR PHYSICAL ADDICTION (THIS WEAKNESS WAS INITIALLY IDENTIFIED BY PHS IN FY 1986); AND

- INADEQUATE COLLECTION OF RENTS AND UTILITIES FOR IHS STAFF QUARTERS.

(4) CONTROL MECHANISM FOR SECONDARY PAYER IN MEDICARE PROGRAM: A DRAFT MANAGEMENT ADVISORY REPORT WAS ISSUED ON SEPTEMBER 8, 1989 RECOMMENDING THAT HCFA IMPROVE THEIR COLLECTION OF HEALTH INSURANCE INFORMATION FOR USE IN THE MEDICARE SECONDARY PAYER (MSP) PROGRAM. OUR REPORT CONCLUDED THAT THE ABSENCE OF ACCURATE AND TIMELY INFORMATION IDENTIFYING PRIMARY INSURANCE OF MEDICARE BENEFICIARIES HAS CAUSED THE MEDICARE PROGRAM TO PAY BENEFITS, ESTIMATED BY HCFA AT \$400 TO \$900 MILLION PER YEAR, THAT ARE ACTUALLY THE RESPONSIBILITY OF OTHER PRIMARY PAYERS. ONGOING AUDITS ARE TRYING TO DETERMINE THE AMOUNT OF LIABILITY THAT IS OWED TO MEDICARE BY PARTICIPATING MEDICARE CONTRACTORS AND OTHER INSURANCE COMPANIES.

TO EFFECTIVELY ADMINISTER THE MSP PROVISIONS OF CURRENT LAW, ACCURATE AND TIMELY INFORMATION IDENTIFYING THE PRIMARY PAYER INSURANCE OF MEDICARE BENEFICIARIES NEEDS TO BE COLLECTED AND USED IN PROCESSING MEDICARE CLAIMS. THE HCFA HAS ATTEMPTED TO COLLECT THIS INFORMATION THROUGH A SERIES OF SPECIAL INITIATIVES. HOWEVER, DESPITE THESE EFFORTS, MORE NEEDS TO BE DONE TO BETTER IDENTIFY PRIMARY PAYERS OTHER THAN MEDICARE AND REDUCE THE MEDICARE OVERPAYMENTS WHICH RESULT FROM UNIDENTIFIED

MSP CASES. MEDICARE CONTRACTORS HAVE A CONFLICT-OF-INTEREST BETWEEN THEIR PRIVATE LINES OF BUSINESS AND MEDICARE WHEN PROCESSING CLAIMS FOR BENEFICIARIES THAT THEY PRIVATELY INSURE.

THE HCFA AND ITS INTERMEDIARIES AND CARRIERS HAVE EXPERIENCED DIFFICULTIES IN IDENTIFYING BENEFICIARIES WITH OTHER HEALTH INSURANCE. ALTHOUGH HCFA HAS IMPLEMENTED A NUMBER OF ADMINISTRATIVE ACTIONS TO IMPROVE THE IDENTIFICATION PROCESS, NONE HAS PROVEN COMPLETELY EFFECTIVE. AS A RESULT, THE LACK OF A MECHANISM TO ASSURE THE RECEIPT OF THE NECESSARY PRIMARY PAYER INFORMATION SIGNIFICANTLY WEAKENS THE SAFEGUARDS AGAINST WASTE, LOSS, AND UNAUTHORIZED USE OF MEDICARE TRUST FUNDS. SINCE LOSSES TO THE MEDICARE PROGRAM FAR EXCEED THE \$10 MILLION THRESHOLD PROVIDED BY OMB FOR IDENTIFYING AND REPORTING MATERIAL INTERNAL CONTROL WEAKNESSES, WE ARE RECOMMENDING THAT THE DEPARTMENT REPORT THIS AS A MATERIAL WEAKNESS TO THE PRESIDENT AND THE CONGRESS IN 1989.

ALTHOUGH HCFA COMMENTS ARE NOT DUE UNTIL OCTOBER 8, 1989, PRELIMINARY INDICATIONS ARE THAT HCFA DOES NOT AGREE THAT THIS IS A MATERIAL WEAKNESS.

(5)PROCUREMENT BY NATIONAL INSTITUTES OF HEALTH: IN RESPONSE TO A REQUEST FROM THE HOUSE COMMITTEE ON

APPROPRIATIONS, OIG PERFORMED A FOLLOW-UP REVIEW TO ASSESS THE STATUS OF NIH'S EFFORTS TO CORRECT PROCUREMENT DEFICIENCIES IDENTIFIED IN AN EARLIER OIG STUDY REPORT. THAT REPORT NOTED THAT NIH WAS NOT OBTAINING ALL POSSIBLE VENDOR DISCOUNTS, DID NOT HAVE A SYSTEM THAT WAS DESIGNED TO TAKE FULL ADVANTAGE OF ITS HIGH VOLUME PURCHASING POWER, AND IN GENERAL COULD ACHIEVE GREATER ECONOMIES AND EFFICIENCIES IN THE PURCHASING OF SMALL DOLLAR ITEMS. PURCHASES THROUGH NIH'S PRINCIPAL SMALL PURCHASING SYSTEM, DELPRO, AMOUNTING TO \$178 MILLION IN FY 1988, INCLUDE EQUIPMENT, SUPPLIES AND SERVICES COSTING LESS THAN \$25,000 WHICH ARE USED TO SUPPORT IN-HOUSE RESEARCH EFFORTS AND RELATED ACTIVITIES.

BASED ON PRIOR OIG RECOMMENDATIONS, NIH DEVELOPED A CORRECTIVE ACTION PLAN TO ADDRESS FOUR CRITICAL PROCUREMENT AREAS: VENDOR DISCOUNTS, REGULATORY COMPLIANCE, THE ORGANIZATIONAL PLACEMENT OF ORDERING PERSONNEL, AND BUYING AUTHORIZATIONS. THE REVIEW FOUND THAT NIH WAS GENERALLY IMPLEMENTING THE PLAN ACCORDING TO ITS SCHEDULED TIME FRAMES. HOWEVER, THE OIG CONCLUDED THAT MODIFYING CERTAIN PARTS OF THE PLAN AND EXPEDITING THE IMPLEMENTATION OF THESE CHANGES COULD RESULT IN ADDITIONAL ECONOMIES BEING ACHIEVED. THE PHS WAS IN GENERAL AGREEMENT WITH OIG'S RECOMMENDATIONS FOR ACCELERATION OF ACTIONS AND MODIFICATIONS TO THE CORRECTIVE ACTION PLAN.

THE OIG ESTIMATED THAT NIH COULD SAVE BETWEEN \$10 MILLION AND \$15.3 MILLION ANNUALLY WHEN CURRENT PROCUREMENT REFORMS ARE IMPLEMENTED IN ITS DELPRO SMALL PURCHASING SYSTEM. IN ADDITION, THE OIG ESTIMATED SAVINGS OF \$3.6 MILLION AND \$5.9 MILLION ANNUALLY IN NIH'S OTHER TWO SYSTEMS THROUGH WHICH IT MAKES SMALL PURCHASES: CENTRALIZED PROCUREMENT AND DECENTRALIZED PURCHASING.

OVERALL, SINCE THE FMFIA PROGRAM BEGAN IN 1982, 265 MATERIAL WEAKNESSES, LIKE THESE CITED ABOVE, HAVE BEEN IDENTIFIED WITH THE DEPARTMENT'S PROGRAM AND SYSTEMS. IN 1989, 19 NEW MATERIAL WEAKNESSES HAVE BEEN REPORTED BY THE IG OF WHICH, MANAGEMENT HAS TENTATIVELY AGREED WITH 5, DISAGREED WITH 7, AND HAS NOT RESPONDED TO 7 OF OUR NOTICES.

RECOMMENDATIONS

IN PERFORMING OUR REVIEWS AND IN PREPARING FOR THIS HEARING, WE CONSIDERED A NUMBER OF RECOMMENDATIONS FOR IMPROVING THE FMFIA PROGRAM. SPECIFICALLY, WE RECOMMEND THAT:

- AGENCIES CONTINUE TO EMPHASIZE THE COMMITMENT TO THE FMFIA PROGRAM AND THAT ALL EXECUTIVES AND APPROPRIATE

MANAGEMENT STAFF ARE HELD ACCOUNTABLE FOR ENSURING THE FULL SUCCESS OF THIS PROCESS;

- THE ASSISTANT SECRETARY FOR MANAGEMENT AND BUDGET SHOULD CONTINUE ACTIONS TO IMPLEMENT AND MAINTAIN AN ADEQUATE OVERALL SYSTEM FOR TRACKING MANAGEMENT ACTIONS TO IMPLEMENT OIG RECOMMENDATIONS;
- FURTHER CLARIFICATION IS NEEDED AS TO WHAT CONSTITUTES A MATERIAL WEAKNESS.
- EMPHASIS IS NEEDED TO UNDERScore THAT THE ACT INTENDS THAT ALL PROGRAM OPERATIONS, ADMINISTRATIVE, AND FINANCIAL FUNCTIONS BE INCLUDED WITHIN THE PROCESS.
- THE ROLE OF THE OIG NEEDS TO BE MORE CLEARLY SPECIFIED. THIS WAS PARTIALLY DONE LAST YEAR, WHEN THIS CONGRESS ENACTED THE INSPECTOR GENERAL AMENDMENTS ACT OF 1988, WHICH REQUIRED IN PART, THAT THE OIG EXPAND HIS SEMI-ANNUAL REPORTING REQUIREMENTS TO INCLUDE MANAGEMENT DECISIONS REGARDING OIG REPORTS WITH QUESTIONED COSTS AND OIG REPORTS ISSUED WITH RECOMMENDATIONS THAT FUNDS BE PUT TO BETTER USE. THESE NEW REPORTING REQUIREMENTS WILL HELP INSURE THAT MANAGEMENT RESPONDS IN A TIMELY FASHION TO OIG RECOMMENDATIONS AND THAT PROMPT ACTION IS TAKEN TO ELIMINATE WASTE AND MISMANAGEMENT.

- THE PRESIDENT'S COUNCIL ON INTEGRITY AND EFFICIENCY SHOULD STUDY WAYS TO IDENTIFY AREAS FOR IMPROVEMENT ON A GOVERNMENT-WIDE BASIS. IT IS QUITE OBVIOUS THAT MANY OF THE WEAKNESSES IN ONE DEPARTMENT COULD ALSO BE FOUND IN ANOTHER.

MR. CHAIRMAN, THIS CONCLUDES MY TESTIMONY. I HOPE THAT MY STATEMENT TODAY GIVES YOU AN OVERALL PICTURE OF WHERE WE STAND WITH REGARD TO MATERIAL WEAKNESSES AT THE DEPARTMENT OF HEALTH AND HUMAN SERVICES. I AM AVAILABLE TO ANSWER ANY QUESTIONS.

STATEMENT OF RAYMOND MARIA
ACTING INSPECTOR GENERAL
U.S. DEPARTMENT OF LABOR
BEFORE
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
OCTOBER 3, 1989

Mr. Chairman and Members of the Committee, it is a privilege to appear before you this morning. I would like to address two topics of great importance to the Office of Inspector General (OIG) at the Department of Labor (DOL): the investigative authority of our office, and the hiring of independent IG counsel. I would also like to inform the Committee of some of the current management and programmatic problems which we have found within the Department.

Investigative Authority

Much has been written and much has been said in recent months about the Department of Justice opinion, issued by its Office of Legal Counsel (OLC), regarding the criminal investigative authority of the Inspector General at DOL. This opinion applies to all IGs, but the DOL Inspector General truly has a vested interest in this subject because the opinion was requested by the

DOL Solicitor, and its effect has been profoundly felt within our office, given the varied and major regulatory program responsibilities of DOL.

I would like to briefly describe some of the events which led the DOL Solicitor to request this opinion. When the Office of Inspector General was established in DOL in 1978, it began to conduct investigations of fraud and abuse in some benefit programs which were not always directly funded by the Department. These included investigations of claimant and provider fraud within the Federal Employees Compensation Act and Black Lung programs, unemployment insurance claimant fraud, and criminal violations of the Longshore and Harbor Workers Act.

These endeavors resulted in a noteworthy rate of successful prosecutions, as well as a maturing investigative capability. The DOL program agencies encouraged these investigative efforts and provided technical and other assistance in many cases. Accordingly, in 1986 the Inspector General began to assess other Department programs in terms of their vulnerabilities to fraud and corruption. The Inspector General identified three areas where these vulnerabilities were present and where the program agencies had placed an inordinate reliance on civil and administrative actions as opposed to criminal remedies: employee benefit plans, worker health and safety, and federal wage and hour statutes. The Inspector General found there was a pressing

need to develop a more effective and more credible criminal enforcement presence in these areas.

With respect to the pension and welfare plan arena, we recognized that fraud and corruption extended beyond union affiliated plans and beyond traditional organized crime elements (which are investigated by our Office of Labor Racketeering). Kickbacks, embezzlement, conflicts of interests, and other criminal violations were also occurring in single-employer benefit plans, and a new breed of racketeers could be found in the ranks of attorneys, accountants, service providers, and others.

Further, we did not find in 1986, and still do not find today, a viable criminal enforcement program within the program agency having jurisdiction in this area, the Pension and Welfare Benefits Administration (PWBA). For example, according to figures provided by PWBA, they "processed" fewer than 25 criminal investigations in 1988. In contrast, in the same year they opened almost 1600 civil and administrative cases. Accordingly, in 1986 the Inspector General directed his Office of Investigations to detect and prevent fraud and corruption in these non-union affiliated benefit plans, which are the basis for the economic well-being and health of much of the American public.

This decision resulted in significant criminal investigations of employee benefit plan corruption. For example:

-- Earlier this year, five individuals associated with Lundberg Industries, Ltd. were indicted in New Mexico on federal charges of mail fraud, embezzlement, and conspiracy to embezzle over \$9 million from a pension fund covering over 900 active and retired employees;

-- In 1987, the owners of a benefit plan service provider company were indicted in West Virginia in connection with a pension fund fraud of \$700,000. These individuals were convicted, sentenced to a year in prison, five years probation, and fined \$35,000;

-- In 1987, a medical plan service provider in Pennsylvania was indicted for submitting false claims of approximately \$200,000 for services never rendered. He was convicted and sentenced to three years imprisonment, five years probation, and full restitution;

-- In 1988, the president of a benefit administration company was indicted in California for embezzling \$54,000 of health benefits from two employee plans. After pleading guilty, he was sentenced to 120 days confinement in a treatment center, five years probation, and restitution.

With respect to worker health and safety, the Inspector General found, as have Congressional committees and others, an appalling lack of criminal enforcement by the Occupational Safety and Health Administration (OSHA). To reinforce this point, I would like to refer to a statement contained in a Report issued last year by the House Committee on Government Operations:

Since the establishment of OSHA some 18 years ago, only 42 cases have been referred by OSHA for criminal prosecution. Only 14 of those

cases were prosecuted, resulting in 10 convictions, with fines or suspended sentences. In the 18-year history of OSHA, no one has ever spent one day in jail for a criminal violation of the OSH Act.

With this track record in mind, the Inspector General directed that resources be used to determine if other ways could be found to punish employers who willfully jeopardize the health and safety of their employees and lie to the government about conditions in their factories or on their construction sites. In doing so, OIG's Office of Investigations was able to re-conceptualize relevant fact patterns in terms of Title 18 criminal violations such as false statements, mail fraud, and conspiracy, whereas OSHA's compliance personnel are limited to the criminal provisions in Title 29, which are restrictive in scope, often difficult to prove, and carry a maximum prison term of six months. (I would point out that OSHA has never asked the Congress to change these Title 29 criminal provisions.)

We believe that criminal enforcement and deterrence must be factored into the OSHA equation in order to prevent needless injuries and deaths. We developed the first federal case where an employer was sentenced to jail for safety and health violations. In this case, the president of the Lancaster (Pa.) Battery Company, whose actions had resulted in the permanent disablement of workers, pled guilty to submitting falsified safety certifications and was sentenced to two and one-half years

in prison (as well as five years probation and a \$30,000 fine). He was not charged with OSHA misdemeanor violations found in Title 29, but with Title 18 false statement violations. I would point out that the United States Attorney did not believe the OSHA investigative report submitted in this matter was complete with regard to the criminal aspects of the case, and he specifically asked the Inspector General to commit resources to investigating these criminal aspects.

Unfortunately, this sentiment is not an isolated one. Following a 1987 high rise construction site collapse in Bridgeport, Connecticut, which resulted in 28 fatalities (one or more fatalities is a prerequisite for OSHA criminal jurisdiction), the United States Attorney for Connecticut stated publicly that the criminal case which was brought to him by OSHA was not sufficient to secure criminal charges. He said, "Simply put, the investigative process triggered by the collapse of L'Ambiance Plaza was not designed to gather the kind of evidence necessary for a criminal prosecution."

In 1986, the Inspector General also saw a need for greater criminal enforcement of various wage and hour statutes, including the Davis-Bacon Act, which prescribes minimum wages and fringe benefits in certain federal construction contracts. Prior to this time DOL's Wage & Hour Division devoted very little effort to criminal investigations (and the FBI did so only rarely).

Therefore, the Inspector General devoted resources to this area, and in conducting these investigations, we tried to assist the program agency's civil and administrative enforcement efforts as well, for example, making sure that restitution and debarment orders were included in criminal plea agreements.

However, in pursuing these criminal investigations and remedies and attempting to improve the enforcement credibility of the Department, we began to encounter increased resistance from the program agencies (PWBA, OSHA, and the Wage and Hour Division). Access to program files and personnel were too often delayed or completely refused, and occasionally program agency resistance escalated to what we believe was deliberate obstruction of our efforts. As an example, I would like to briefly discuss an investigation which is still pending but is most telling.

We were notified by a wage and hour compliance officer in the field that she believed a sub-contractor who was engaged in the construction of a nursing home had bribed his employees to lie to her, in order to reduce a proposed civil penalty under the Davis-Bacon Act. Our Office of Investigations initiated an undercover scenario using recording devices in order to gather evidence of the bribe solicitation. In doing so, we were able to develop information concerning potential bribes to not only employees but

also to federal officials, as well as evidence of other significant federal violations.

The investigation reached a point where it was necessary to obtain additional cooperation from the Wage and Hour Division of DOL in order to maintain the pretense of the undercover operation. However, when asked to cooperate both by our office and the United States Attorney's Office, the Wage and Hour Division delayed its response for more than six weeks and essentially refused to cooperate further, pursuant to advice which they stated they received from the Office of the Solicitor. During meetings with OIG, officials of the Wage and Hour Division and the Solicitor's Office told us they did not believe in criminal investigations and their primary objective was the recovery of back wages. They refused to either allow one of our agents to continue to pose as a wage and hour compliance officer, or to have one of their compliance officers participate in an undercover capacity, a law enforcement technique which is legitimate and commonplace in attacking institutional corruption.

This refusal to cooperate resulted in a premature termination of the undercover operation and precluded the collection of evidence needed to document certain violations, including: fraud against HUD and various lending institutions; fraud against HHS by virtue of inflated nursing home construction costs and reimbursement for services provided to patients; public corruption in the form of

bribery; labor corruption in the form of payoffs; and other significant Davis-Bacon Act violations.

Overall, rather than encouraging OIG to conduct investigations in these areas, these three program agencies all resisted in varying degrees. Some believed we were usurping their responsibilities and they complained about our efforts. For some, the Inspector General was rocking the boat and disrupting the comfortable relationship between the regulators and the regulated community. However, in our view these agencies had neither a comprehensive enforcement strategy nor an adequate criminal enforcement capability.

These sentiments eventually led to the request by the Solicitor to OLC (in September, 1988) for an opinion regarding our investigative authority. I would add that this request was made without any consultation with the Office of Inspector General, and it framed the issues in a manner which could only be responded to in the broadest fashion.

As a result of the OLC opinion, the Office of Inspector General has suspended over 1200 pending criminal investigations and has shifted its resources to other areas which, although meaningful, clearly have less potential impact upon the health, safety, and welfare of the American worker. This decision has been made, despite our disagreement with OLC's legal analysis, due to the

potential personal liability for OIG agents and managers. The suspended cases encompass the following areas:

-- Unemployment Insurance Fraud	993 cases
-- Wage & Hour Program Fraud and Abuse	157 cases
-- Black Lung Program Fraud	49 cases
-- Longshore & Harborworkers Program Fraud	21 cases
-- OFCCP Program Fraud and Abuse	1 case
-- Mine Safety and Health Fraud and Abuse	1 case
-- Occupational Safety and Health Fraud and Abuse	7 cases
-- Employee Benefit Plan Fraud and Abuse	15 cases
-- Alien Certification Program Fraud & Abuse	20 cases

The opinion issued by OLC interprets language in the Inspector General Act of 1978 regarding the responsibilities of the IGs. I would submit to you this morning that we are now past the point of interpreting the 1978 statute. We are at the point where this Committee, and Congress as a whole, needs to tell the IGs exactly what we should or should not be investigating. And in asking for this direction, we submit that if the DOL Inspector General is not allowed to conduct criminal fraud investigations involving the Department's "regulatory" programs or involving a DOL program which is not entirely funded by Department dollars, then the public will be ill-served and the American working force will be the losers.

Although we recognize there is disagreement over the OLC opinion and the issue of investigative authority, I will try to explain why it is prudent from the perspectives of economy, efficiency, and just plain good government to allow OIG to investigate fraud and corruption in those agency programs which are not directly funded by DOL. Simply put, if OIG does not conduct these investigations, they will, in almost all instances, disappear.

In making this statement, OIG does not contend that the DOL program agencies fail to conduct any criminal investigations. We, however, do contend that there are not enough investigations, not enough indictments, and not enough convictions to achieve a credible deterrence, which is the only way to achieve compliance with the law. An inordinate reliance on civil and administrative remedies will not promote such deterrence. Such an approach tends to foster an environment in which the transgression is worth committing because the benefits are so high and the risks and costs of being caught are so low. Indeed, those who would consider committing violations in this environment pause only to ask, "Can I afford the fine?"

Unfortunately, the Department of Labor has consistently manifested an institutional reluctance to vigorously pursue criminal enforcement. This reluctance is perhaps best illustrated by a 1988 effort to assess enforcement within the Department and make recommendations for future enforcement

strategies. Even though there was extensive input by the Office of Inspector General, a Department task force drafted a "Report" (never released) which failed to mention criminal remedies in relation to any DOL program.

Further, even if the Department were to tell this Committee that this attitude is changing and criminal enforcement will become a higher priority, with additional resources being devoted to this effort, this will take considerable time: time to obtain the authority to hire trained criminal investigators and time to actually hire them, time to have these individuals educate themselves about the programs they will be investigating, time to secure effective relationships with prosecutors and other law enforcement personnel, and time to develop necessary contacts and informants.

These promises regarding criminal enforcement have been made before by DOL, and they have been broken. In 1982, the Department provided assurances to this Committee's Subcommittee on Investigations that it would "meet its responsibility to protect pension and welfare benefits against criminal exploitation." Seven years later, we believe this commitment has not been kept.

Meanwhile, based upon our experiences, the FBI, which has jurisdiction over a broad range of federal criminal violations,

has other priorities which will probably preclude a vigorous and continuous presence in these areas. Further, these cases often involve, for the FBI, unfamiliar substantive violations.

I would submit that in this era of fiscal restraint and concern, it is not practical to reinvent the wheel to develop a capability which already exists. The DOL Office of Inspector General currently has the only GS-1811 criminal investigators in the Department, and it has developed, over its eleven years of existence, a broad knowledge of DOL's regulatory programs and the abuses which exist within them. The DOL OIG has the experience and ability to use the broad spectrum of criminal offenses found in Title 18, and we are willing and able to conduct these criminal investigations, not exclusively, but concurrently with the program agencies.

It is my understanding that there are other Inspectors General who are not as concerned about the OLC opinion and its ramifications either because their agency has no significant regulatory programs or, if they do, because the IG has resource or other limitations. I would submit to this Committee that there is a distinction between having authority and exercising such authority. The Inspector General at the Department of Labor wants to conduct these types of criminal investigations in order to protect American workers. But in order to do so, we need your legislative imprimatur.

The OLC opinion states we do not have this authority under the IG Act and further states the Secretary of Labor cannot delegate this investigative authority to us. While there may be legal disagreements over the issue of statutory authority, we are at a loss to understand why the Secretary cannot delegate criminal investigative authority if so desired, using section 9(a)(2) of the IG Act or otherwise.

Let me emphasize that we are not attempting to acquire "program operating responsibilities." We have no desire to duplicate, nor have we ever maintained that we have the authority to duplicate, the compliance and regulatory activities of the Department of Labor. Investigations of criminal fraud and corruption are simply not synonymous with compliance and regulatory activities.

Although all enforcement decisions, whether they be civil, administrative, or criminal in nature, have "program operating" overtones, we believe these considerations are minimal when the issue at hand is criminal fraud. When Congress enacts criminal laws, it does so with the belief that certain conduct is wrong and with the expectation that whoever engages in this conduct should be punished. Further, it does so with the expectation that decisions regarding the initiation of investigations and the referral of cases for prosecution will not be politicized and will not be swayed by the relationship between the regulators and

the regulated community. This was one of the basic reasons for the establishment of the IGs in 1978.

Now, in 1989, we need to know if Congress truly wishes to have vigorous and objective criminal enforcement within regulatory programs and whether it wishes to tell individuals who fraudulently obtain government benefits that they will be detected and prosecuted. If it does, the expertise and experience of the IGs should be welcomed, and the IGs should be given the necessary authority, either through legislation or appropriate delegations.

Independent Inspector General Counsel

Another major problem which we have experienced in the Department of Labor during the past year is the refusal of the Secretary of Labor and the Solicitor to acknowledge the Inspector General's authority to hire his own attorneys under the IG Act of 1978, or to definitively respond to our request to internally transfer our attorneys from the Office of the Solicitor to the Office of Inspector General. It is our understanding that, with one exception, every other IG Office (established prior to the 1988 amendments) has either independent counsel or an agency agreement providing for some requisite degree of independence.

From the inception of the Inspector General in the Department of Labor, the IG counsel has been functionally and physically located in the Office of the Solicitor. Although discussions about a Memorandum of Understanding between the Inspector General and the Solicitor have been undertaken several times in the past eleven years, no MOU has ever been truly negotiated.

Last December, after several incidents reinforced the belief that the need for independent counsel had become essential, Inspector General Hyland informed the Department that, pursuant to his authority under the IG Act, he was electing to transfer the legal services function from the Office of the Solicitor to his own office and that he planned to hire the four attorneys and one clerical employee who currently provided these services within the Office of the Solicitor.

The then-DOL Solicitor responded by stating that not only was a transfer of this function contrary to two Secretary's Orders (a 1980 order creating the Office of Inspector General and a 1940 Order stating that all legal services will be provided by the Office of the Solicitor), but that the decision was also "fraught with legal difficulties and risks." In essence, the Office of the Solicitor threatened these individuals and implied that hiring them could be a violation of law and that any compensation or benefits accrued by them could be invalid and subject to collection or disallowance at a later time.

The Inspector General provided the Department with documentation supporting his hiring authority under the IG Act, as well as an alternative Memorandum of Understanding which would have permitted the IG counsel and her staff to remain in the Office of Solicitor with additional independence. The only concrete response received after any number of informal requests was a memorandum from the then-Deputy Secretary ordering Inspector General Hyland not to proceed with his plans, pursuant to the "general supervision" clause of the IG Act. Although relations between the Office of Inspector General and the DOL administration have been more amicable since Secretary Dole's arrival, the issue concerning independent counsel remains unresolved.

The problems which led to Inspector General Hyland's decision to hire his own counsel remain. Any first year law student knows that an attorney cannot serve two clients with competing interests. Our lawyers are in a position of inherent conflict on a daily basis and they are unable to provide us with truly independent legal advice and representation. In turn, the statutorily mandated independence of the Office of Inspector General is compromised. Our office is simply not like other program agencies within the Department; we are expected to be a dissenting voice when necessary.

Due to their functional location, our attorneys rely upon the Office of the Solicitor for actual supervision, ratings, promotions, awards, etc., rather than OIG, which can truly and accurately evaluate their work. Due to their position within a division of the Office of Solicitor, their views and ours are not received directly by the Solicitor, but are filtered through their supervisor. Frequently, our lawyers are conspicuously and studiously kept out of the loop entirely or until the last possible moment on issues of major importance to the Department. The Solicitor and the Department are thereby deprived of potentially valuable input available from an IG perspective.

All of the practical reasons supporting the transfer, however, beg the ultimate issue before this Committee today: What authority is granted to the Inspector General in the IG Act, and specifically, does it include the authority to hire independent counsel? We have read the legislative history of the Act, which indicates that Congress found it unnecessary to include a specific statutory provision because the authority of an Inspector General to hire counsel was absolutely clear. Therefore, we regret that we have reached this stage and that we have to bring this matter to your attention. Unfortunately, the Department's actions in this matter leave us no choice.

Department of Labor Management and Programmatic Problems

The mandate which Congress has given to the Inspectors General includes the identification and reporting of agency management and programmatic problems. Our semiannual reports attempt to highlight the most significant Department problems, as well as the steps being taken to address them. In the context of this hearing, I would like to briefly discuss several major problems which we have previously reported to the Department and its program agencies.

I believe this Committee is most interested in internal financial systems and controls. Unfortunately, we have found, through financial statements compiled and audited for Fiscal Years 1986 through 1988, that the Department of Labor has significant internal financial control deficiencies. These deficiencies include accounting or internal control problems in such major areas as grants management, trust fund accounting, property, general ledger controls, and financial reporting. Our audits have revealed that the Department's accounting system and other financial management systems do not fully interface and they possess significant information gaps and control weaknesses.

We are particularly concerned about grants management problems, for example, the Department's reliance upon grantee financial

information which is of unproven accuracy and validity, because DOL grantees account for over 85% of the Department's total expenditures.

While the Department has stated that the implementation of a new departmental accounting system will alleviate many of these problems, this system is not yet operational.

With respect to individual DOL programs, we are most concerned about the operation of the Job Training Partnership Act (JTPA). The success of this program depends upon the Federal and state partners being both accountable to each other and to their funding source in Congress. Our audit work has shown that accountability at all levels of the program is lacking and, as a result, Congress and the Department of Labor have no ability to comprehensively evaluate the program to determine if its intent is being realized. We believe that six specific areas need greater accountability: targeting, cost accountability, procurement, recordkeeping, reporting, and monitoring. Although we are working with the Department on a regular basis, and several bills which address our concerns have been introduced in Congress, it is too early to determine what effect these efforts will have.

In addition to our previously stated concern over criminal enforcement of employee benefit plan fraud and corruption, we

have also recently reported our concerns over the role of IPAs (independent public accountants) in ERISA-covered plans. We concluded in a 1987 report that PWBA had not:

- conceptualized how the work of IPAs can be used to enhance and expand PWBA's enforcement and/or disclosure responsibilities, nor;
- instituted a quality control program to ensure that IPA audits, performed on behalf of plan participants, provide the maximum protection to these participants by assuring that audits are performed and reported in accordance with the American Institute of Certified Public Accountant (AICPA) guidelines for pension and welfare plans.

In their response, PWBA disagreed with our conclusions, but agreed to establish an Office of Chief Accountant, who would establish a quality control program. That office has been created and staffed. However, we believe PWBA has yet to perform reviews of IPA reports in any meaningful way.

Thank you for your time this morning. I would be pleased to answer any questions.

U.S. Department of Labor

Inspector General
Washington DC 20210

OCT 26 1988

HAND DELIVERED

The Honorable John Glenn
Chairman, Committee on Governmental Affairs
United States Senate
340 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

During my appearance before the Committee on October 3, you requested that the Department of Labor, Office of Inspector General (OIG) provide the Committee with background materials related to the Office of Legal Counsel (OLC) opinion concerning the investigative authority of Inspectors General.

The materials found in OIG's files are attached, preceded by a chronology. As stated during my testimony, OIG received no notification from the Solicitor prior to the transmittal of his original memorandum to the Deputy Secretary (September 9, 1988). Although Inspector General Hyland received a copy of this memorandum on September 20, the Deputy Secretary had already asked the Solicitor to contact OLC, and OIG had no opportunity to provide any input before the Solicitor's formal written request to OLC (September 23).

Please contact me, at 523-8545, if any additional assistance is needed from my office.

Sincerely,

A handwritten signature in cursive script that reads "Raymond Maria".

RAYMOND MARIA
Acting Inspector General

Enclosures

CHRONOLOGY OF DOCUMENTS RELATED TO OLC OPINION

Sept. 9, 1988	Memorandum from Solicitor of Labor to Deputy Secretary re: OIG investigative authority
Sept. 20, 1988	Memorandum from Deputy Secretary to Inspector General
Sept. 23, 1988	Letter from Solicitor of Labor to OLC requesting legal opinion
Oct. 24, 1988	Letter from Inspector General to OLC, enclosing Oct. 17 memorandum from Inspector General to Deputy Secretary and Oct. 6 memorandum from HHS Inspector General to Deputy Secretary
Oct. 27, 1988	Memorandum for DOL Inspector General to all Inspectors General
Oct. 28, 1988	Letter from OLC to Solicitor requesting additional information
Oct. 28, 1988	Letter from OLC to Inspector General re: request to Solicitor for additional information
Dec. 5, 1988	Letter from Solicitor to OLC providing additional information
Dec. 22, 1988	Letter from Inspector General to OLC re: response to Dec. 5 Solicitor's letter
Jan. 6, 1989	Transmittal from OIG to OLC re: request for copy of OIG/FBI Memorandum of Understanding
Jan. 13, 1989	Transmittal from OIG to OLC re: request for copy of <u>United States v. H.P. Connor</u>
Feb. 22, 1989	Letter from Inspector General to Attorney General requesting expedited opinion from OLC
Mar. 9, 1989	Memorandum from OLC to Acting Solicitor (OLC opinion)
Mar. 27, 1989	Memorandum from Inspector General to Secretary Dole re: OLC opinion
Apr. 3, 1989	Letter from Inspector General to OLC re: OLC opinion

U.S. Department of Labor

Office of Inspector General
Washington, D.C. 20210HAND DELIVERED

NOV 6 1989

The Honorable John Glenn
Chairman, Committee on
Governmental Affairs
United States Senate
Washington, D.C. 20510-6250

Dear Mr. Chairman:

Thank you very much for your kind remark regarding my testimony at the October 3, 1989 hearing. As you have requested in your letter of October 17, 1989, the following are the responses to questions that were not asked at the hearing.

Question #1

Federal Employees' Compensation Act (FECA) costs rose from \$1.14 billion for the year ending 6/30/88 to \$1.27 billion for the year ending 6/30/89 (an increase of \$129 million or 11.3%). Your prepared remarks do not mention fraud, waste and abuse within the FECA program. What is your opinion regarding the amount of fraud in that program and what efforts have you devoted to this area?

Answer:

Our Office of Audit has devoted considerable resources in the Federal Employees' Compensation Act program over the last 3 years. They have performed limited internal control reviews of FECA systems and found that the control systems are adequate to identify instances of fraud. This does not mean that fraud may not occasionally occur. No system is perfect and the Department must weigh the cost of the control against the cost of potential fraud. While most of the Office of Audit's work was involved with examining in-house control systems, our Office of Investigations would be involved with investigating fraud being perpetrated by Federal employees who are receiving FECA benefits. Information on FECA cases referred to U.S. Attorneys for prosecution is provided below, in response to question 2.

Question #2

How many FECA cases has the Department of Labor IG referred to U.S. Attorneys for criminal prosecution? Does the OLC opinion affect your ability to do these cases?

Answer:

Our records show that:

In Fiscal Year 1987, OI referred for prosecution 27 cases involving 30 subjects. Of the cases referred for prosecution, one was sent to local prosecutors; the remainder were referred to Federal prosecutors.

In Fiscal Year 1988, OI referred for prosecution 36 cases involving 40 subjects. Of the cases referred for prosecution, two were sent to local or state prosecutors; the remainder were referred to Federal prosecutors.

In Fiscal Year 1989, OI referred for prosecution 28 cases involving 30 subjects. Of the cases referred for prosecution, three were sent to local or state prosecutors; the remainder were referred to Federal prosecutors.

We believe that the OLC opinion has not affected our ability to investigate these cases. However, we did not receive definitive directions from the OLC as to how each case category is affected.

Question #3

Your testimony stated that there is no accountability for the federal funds expended on the Job Training Partnership Act (JTPA) program. In view of the fact that this is a block grant program, what are your specific recommendations for improving the Department's oversight?

Answer:

JTPA was enacted in 1982 to establish programs providing job training to economically disadvantaged individuals, individuals facing serious barriers to employment, and dislocated workers who need the assistance of such training to obtain productive employment. In passing JTPA, Congress recognized that job training is not an expense but an investment in human capital and mandated that criteria be developed to measure the return on that investment. More specifically, the Congress stipulated that the return be measured by increased employment and earnings of participants and reduction in welfare dependency.

Since program inception, approximately \$18.5 billion has been allocated to states for JTPA Titles II and III.

JTPA relies on ETA-established national program performance standards. But governors have the option of either adjusting the standards to accommodate local conditions or establishing standards of their own. Success in JTPA depends upon the Federal and state partners being accountable to each other and to their congressional funding source. Our audit work consistently shows lack of accountability at all program levels, and numerous situations which we believe are abusive. For example: Examples can be provided on request.

We believe that legislation is needed to improve basic program accountability to prevent such abuse. Currently, the Senate (S. 543), the House (H.R. 2039 and H.R. 3266), and the Administration have all proposed amendments to JTPA which should increase accountability.

OIG has, on two occasions, testified on the program and proposed amendments. In September 1988, OIG testimony cautioned that the program needed to:

1. enhance JTPA program targeting to better serve the most-in-need of the eligible population; and
2. eliminate 20 CFR 629.38(e)(2), which, in certain cases, allows JTPA costs to be allocated entirely to the training category irrespective of the cost categories that actually benefited, from JTPA regulations to increase program accountability and to prevent program operators from violating the law.

In September 1989, OIG testimony centered on six specific program areas which need greater accountability to prevent abuse: targeting, cost accountability, procurement, recordkeeping, reporting, and monitoring. Many of these issues are being addressed through legislative initiatives or the audit resolution process.

The proposed JTPA amendments all contain provisions to target the program more specifically toward serving individuals with multiple barriers to employment. This program redefinition is a positive step; however, the complementary element of how best to serve the targeted population is still unknown.

The proposed JTPA amendments also call for mandatory data sharing between the Departments of Education, Health and Human Services, and Labor. This data sharing is essential for developing measures which address goals of long-term employability and reductions in welfare dependency. We recommend, however, that H.R. 2039 more specifically prescribe data elements, such as uniform outcome measures, which must be uniformly collected across agency lines and within DOL itself. Proposed JTPA amendments and the Jobs Program under the Family Support Act require data collection on the number of individuals experiencing multiple barriers to employment as well

as information relating to improved education and occupational skills.

To avoid stifling legitimate information collection, H.R. 2039 may need to direct legislatively the collection of specific measures for program targeting and evaluation. In response to our initial report on JTPA Participant Training and Services, ETA implemented standards for job retention and post-program earnings and requested permission to collect other relevant information on skills deficiencies and competency attainments. ETA's request to collect uniform preprogram information on skills deficiencies was rejected by OMB and measures of competency attainments took more than 2 years to gain approval.

Since the program's inception, it has become more difficult to determine whether JTPA recipients have complied with basic program restrictions on cost limitations and unreasonable profits because the system is increasingly relying on fixed unit price, performance-based contracts (FUPCs).

ETA's regulations, at 20 CFR 629.38(e)(2), govern FUPCs and allow JTPA costs to be allocated entirely to the training cost category, charging none to the administration and participant support cost categories, if the agreement with the service provider is for training, and if full payment is contingent on the participant's completion of training and placement in the occupation trained for at or above the agreed-upon wage. These contracts entail some assumed risk on the provider's part.

Currently, by using FUPCs as allowed by 20 CFR 629.38(e)(2), contractors can avoid financial risks by establishing contractual payment points that ensure expenses will be recouped and unrealistic profits earned, even in the event of less than full performance. Our audits have uncovered numerous situations where contracts were modified to eliminate any penalty for the possibility of contractor failure. For example, in one contract, payment points for required referrals, mid-point completions, completions, placements and job retentions were all reduced or revised when the contractor was unable to satisfy contractual stipulations. In fact, at the end of the contract period when some of the requirements still were not met, the contract was changed again, this time retroactively at the contractor's request, to allow an additional payment of \$292,000. Thus, a cost reimbursement contract was effectively created 6 months after the fact.

In March 1989, ETA issued an interpretation of the regulation governing FUPCs which attempts to guide the JTPA system toward writing "acceptable" fixed unit price, performance-based contracts. ETA conceded, however, that many of the elements of its interpretation are "policy provisions recommended for adoption by states and are not found within the specific language of 20 CFR 629.38(e)(2) and, therefore, are not required." We continue to find no basis in the statute for the regulation's existence and

believe that its continued use effectively neutralizes the congressional mandate on spending limitations within the program's cost categories.

If the regulation remains, JTPA amendments can take several steps to bring accountability for the cost limitations into the program. A key amendment would be to legislatively require, as H.R. 3266 does, that the Secretary of Labor specifically define the cost categories. However, we suggest that these definitions reference activities defined under Section 204 of the Act and relate allowable cost charges to the categories to the extent that those categories receive benefits. We support provisions of the Administration's proposal which require a breakdown of cost components and charging these costs to the appropriate cost categories in all but very limited circumstances, as defined in Section 141(d)(3) of the Act.

Another suggestion is to establish a fourth cost category, described as "Employment Assistance Services," for activities such as job search, counseling, employer outreach and work habit modification. This would isolate the funds spent on true training and parallel the JTPA Title III Economic Development and Worker Adjustment Assistance (EDWAA) program for dislocated workers which identifies such services as "Basic Readjustment Services."

Procurement. JTPA's original intent was to decentralize procurement policy to the state and local level and to allow local decisionmakers to provide services that meet local needs. In practice, we have found that state and local procurement systems often are not designed to procure training services. H.R. 3266, introduced by the Subcommittee on Employment Opportunities, contains provisions which would assure greater control over JTPA procurements. These provisions would establish minimum baseline procurement controls which all states must meet. They enhance overall accountability for procurement actions by prohibiting conflicts of interest, requiring maintenance of procurement records, encouraging competition, and requiring cost and price analyses in the award of JTPA contracts.

Without adequate procurement controls, the system will continue to ignore program integrity and waste program funds.

FUPCs still offer the potential for excessive contractor profits because no requirements exist for disclosure of profit margins or related cost and price analyses and contractors are free to set prices without regard to actual costs.

While there may be a legitimate role for the private sector to provide JTPA services, and fixed unit price contracting is one method of allowing these contractors a reasonable level of profit, there is no rationale for governmental and non-profit entities to operate under profit-making FUPCs. Historically, these entities have operated quite successfully under cost reimbursement contracts and the evidence we have seen to date indicates no need for change.

The need to limit use of FUPCs becomes more evident when considering data we collected as part of our audit work on program years 1984-1986. The data showed that for 18 frequently trained occupations, the cost differential between providing that training via cost reimbursement versus fixed unit price, performance-based contracts was significant. Our comparison showed that, on average, FUPCs cost 42 percent more per contract while providing 26 percent fewer hours of training than did cost reimbursement contracts. When these two findings are merged to determine the average cost per training hour, fixed unit price, performance-based contracting produces training interventions which cost 88 percent more than cost reimbursement contracting does.

Recordkeeping, too often assailed as an unnecessary intrusion of government upon the local level, remains the chief means by which Congress and program officials are able to account for and evaluate programs.

OIG strongly supports the recordkeeping provisions of H.R. 3266. These provisions simply require any recipient, subrecipient, or service provider receiving funds under JTPA to maintain records of revenues and expenditures for the duration of the grant, subgrant, contract, or other agreement. This requirement is especially critical when dealing with fixed unit price, performance-based contracts.

Currently, ETA regulations do not specifically address record-keeping requirements governing these contracts. In practice, contractors are not required to maintain any records beyond those which relate directly to contract performance, for example, participant records. Records of contractor expenditures and similar financial records are not required to be maintained. Adequate program reporting allows Congress to assess program performance and adherence to legislative requirements. The current law, as well as proposed amendments, identifies limitations on certain costs as being applicable to funds available to an SDA for any fiscal year. OIG believes that if the amendments included provisions instead to require the limitations be applicable to funds expended by an SDA in any fiscal year, the ability to determine compliance with, and thus enforce, the statutory cost limitations would be greatly enhanced. If the Act retains the "funds available" language, it also needs to report expenditures by year of obligation by cost category.

We also believe that changes in the frequency of Federal reporting would improve stewardship over the JTPA program. We recommend that the amendments require quarterly financial reporting by states and SDAs. Most entities' fiscal years end on March 31, June 30, September 30, or December 31. By requiring quarterly Federal reports with these ending dates, information contained on Federal reports may be closely linked to the entity's audited financial statements.

The final policy area which H.R. 2039 can positively impact is program oversight and monitoring. Based on our observations, neither the Department nor the governors have placed sufficient emphasis on program oversight.

Many of our recommendations for JTPA amendments focus on the JTPA system's use of fixed unit price, performance-based contracting. OIG is not proposing that this method of contracting cannot serve a positive purpose in carrying out congressional program intent, if its use is limited and well controlled. If written to assure reward only for legitimate risk taking, this contracting method can obtain a potentially better product from the private sector for the funds spent.

We are proposing limiting the use of PUPCs to private sector providers and prohibiting its use by governmental and nonprofit entities. Even when used by private sector providers, the amendments should require that such contracting include provisions for cost and price analyses, defective pricing, recordkeeping and conflict of interest.

Amending the Job Training Partnership Act, we believe, presents an opportunity to confirm the program's original goals and objectives as well as to increase accountability and minimize abusive practices. We encourage Congress to support legislation which will result in a maximum return on investment, as originally envisioned 7 years ago.

Question #4

The Department has acknowledged that there are weaknesses in its ERISA enforcement program, which causes great concern about the safety of the 1.6 trillion dollars in private employee benefit plans. Given this, why hasn't the Department cracked down harder on the independent public accountants who audit those plans?

Answer:

We recommended in December 1987, that PWBA take steps to institute a quality control program. In response, they created an Office of Chief Accountant. However, almost 2 years after our recommendation, we believe that PWBA is still trying to conceptualize what their quality control program should look like, and they have taken no action to implement their own regulations which allow them to have another IPA audit the plan in question, if the first audit is found to be seriously deficient.

Question #5

According to your figures, in 1988 the Pension and Welfare Benefits Administration opened almost 1600 civil and administrative cases, compared to 25 criminal investigations. Have you or anyone else examined those 1600 civil cases to determine if there was a criminal element that was overlooked?

Answer:

OIG has not performed an analysis of the 1600 civil and administrative cases, nor do we know if GAO took a comprehensive look at the cases to identify potential criminal matters.

Question #6

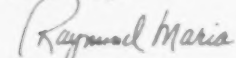
How well is the Federal Managers' Financial Integrity Act process working in the Department? Do you have any suggestions for improving the process?

Answer:

Deputy Secretary DeArment, in a memorandum dated July 21 to OMB Director Darden, concluded that the basic framework for an effective internal control program exists within the Department and the inherent weaknesses in the Department's programs have been disclosed to the President and to the Congress. We also believe that this is the case.

Should you have any further questions, please have your staff contact Joe McGowan at 523-6747.

Sincerely,



RAYMOND MARIA
Acting Inspector General

TESTIMONY OF JOHN C. MARTIN
INSPECTOR GENERAL
U.S. ENVIRONMENTAL PROTECTION AGENCY
BEFORE THE
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

OCTOBER 3, 1989

GOOD MORNING, MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE.

I AM PLEASED TO HAVE THIS OPPORTUNITY TO DISCUSS RECENT AUDIT AND INVESTIGATIVE WORK BY THE OFFICE OF INSPECTOR GENERAL AT EPA RELATING TO SIGNIFICANT MANAGEMENT PROBLEMS FACING THE AGENCY. SPECIFICALLY, I WILL DISCUSS AUDITS OF THE ENFORCEMENT FUNCTIONS OF EPA, ITS CONSTRUCTION GRANTS PROGRAM, AND ITS CONTRACTS MANAGEMENT PROGRAM. I WILL ALSO DISCUSS A SERIES OF INVESTIGATIONS INTO A VERY LUCRATIVE SCHEME OF FALSELY CERTIFYING THAT IMPORTED LUXURY CARS MEET FEDERAL STANDARDS. THESE AUDITS AND INVESTIGATIONS FOCUSED ON AGENCY ACTIVITIES BETWEEN FISCAL YEARS 1984-1988.

ENFORCEMENT

SINCE 1986 MY OFFICE HAS ISSUED SEVERAL AUDIT REPORTS WHICH CONTAINED AN EVALUATION OF THE AGENCY'S COMPLIANCE WITH ITS ENFORCEMENT POLICIES. WE HAVE FOUND A COMMON SIGNIFICANT DEFICIENCY DURING OUR EVALUATIONS. NAMELY, WE FOUND THAT THE AGENCY IS NOT VIGOROUSLY ENFORCING ITS LAWS AND REGULATIONS.

PENALTIES

WE FOUND CASES WHERE APPROPRIATE PENALTIES WERE INADEQUATELY CALCULATED OR NOT CALCULATED AT ALL FOR MAJOR VIOLATIONS. ALSO, CALCULATED PENALTIES WERE REDUCED DURING NEGOTIATIONS, IN SOME CASES IN EXCESS OF 90 PERCENT AND AMOUNTING TO MILLIONS OF

DOLLARS, WITH LITTLE OR NO DOCUMENTATION TO SUPPORT THE REDUCTIONS. IN MANY CASES, THE FINANCIAL BENEFITS THE VIOLATORS RECEIVED FROM NOT COMPLYING WITH EPA REGULATIONS WERE NOT RECOVERED THROUGH PENALTY ASSESSMENTS, MAKING IT ECONOMICALLY ADVANTAGEOUS FOR VIOLATORS TO BE IN VIOLATION OF THE LAW.

INADEQUATE CALCULATION OF PENALTIES AND INSUFFICIENT DOCUMENTATION TO SUPPORT PENALTY REDUCTIONS GREATLY RAISES THE POTENTIAL FOR FRAUD OR ABUSE IN EPA'S PENALTY PROGRAM. ALSO, GAO'S STANDARDS FOR INTERNAL CONTROL SYSTEMS, WHICH REQUIRE THAT ALL TRANSACTIONS AND EVENTS BE CLEARLY DOCUMENTED AND THE DOCUMENTATION AVAILABLE AND EASILY ACCESSIBLE FOR EXAMINATION, WERE NOT MET. THE AGENCY DID NOT OBTAIN MAXIMUM DETERRENCE NOR ENSURE FAIR AND EQUITABLE TREATMENT OF THE REGULATED COMMUNITY. ACCORDINGLY, THESE VIOLATORS MAY HAVE GAINED AN ECONOMIC AND COMPETITIVE ADVANTAGE OVER THOSE WHO SPENT THE TIME AND RESOURCES TO COMPLY WITH ENVIRONMENTAL REQUIREMENTS, SUCH AS THOSE CONTAINED IN THE CLEAN AIR AND WATER ACTS.

RCRA ENFORCEMENT ORDERS

WE HAVE FOUND THAT WHEN EPA ISSUED ENFORCEMENT ORDERS, SUCH AS CONSENT AGREEMENTS AND FINAL ORDERS, AGENCY OVERSIGHT WAS NOT ADEQUATE TO ENSURE COMPLIANCE WITH PROGRAM REQUIREMENTS. FROM A JUDGMENTAL SAMPLE OF ENFORCEMENT ORDERS IN THE RCRA PROGRAM, WE CONCLUDED THAT ABOUT 80 PERCENT OF THE FACILITIES SAMPLED WERE EITHER NOT RESPONDING TIMELY AND ADEQUATELY, OR THERE WAS NO CLEARLY DOCUMENTED EVIDENCE OF THEIR COMPLIANCE WITH THE TERMS INCLUDED IN THE ENFORCEMENT ORDERS. WITHOUT TIMELY AND ADEQUATE

COMPLIANCE, THE POTENTIAL EXISTS FOR ENVIRONMENTAL DEGRADATION WHILE VIOLATORS GAIN ECONOMIC BENEFITS BY AVOIDING THE COSTS OF COMPLIANCE.

EPA ENFORCEMENT ORDERS FREQUENTLY LACKED PENALTIES FOR NONCOMPLIANCE, AND PROGRAM OFFICIALS FAILED TO CONDUCT TIMELY FOLLOW-UP SITE INSPECTIONS TO ASSURE COMPLIANCE. IN ADDITION, INFORMAL MODIFICATIONS BY EPA STAFF IMPROPERLY SOFTENED THE ORIGINAL REQUIREMENTS OF THE ORDERS.

NPDES COMPLIANCE

EPA'S MULTIBILLION DOLLAR PROGRAM TO CONSTRUCT WASTEWATER TREATMENT FACILITIES HAS SOMETHING CALLED THE NATIONAL POLLUTANT DISCHARGE ELIMINATION SYSTEM WHICH MEASURES HOW WELL THE NATION'S SEWAGE PLANTS ARE COMPLYING WITH THEIR PERMITS TO DISCHARGE TREATED WASTEWATER. IN A RECENT REVIEW, WE FOUND THAT PERMIT COMPLIANCE MONITORING INFORMATION IS INACCURATE, OR IN SOME CASES, TOTALLY ABSENT. FACILITIES WERE IMPROPERLY REPORTED AS RETURNED TO COMPLIANCE AND REMOVED FROM THE SIGNIFICANT NONCOMPLIANCE LIST EVEN THOUGH CORRECTIVE ACTIONS HAD NOT BEEN TAKEN. THUS, MANY OF THE NATION'S CHRONIC WASTEWATER TREATMENT VIOLATORS WERE EXCLUDED FROM THE OVERSIGHT PROCESS. AS A RESULT, NPDES COMPLIANCE MONITORING REPORTS DID NOT HAVE ACCURATE INFORMATION FOR EVALUATING OVERALL NATIONAL COMPLIANCE RATES.

OTHER REPORTS ON EPA ENFORCEMENT

THE U.S. GENERAL ACCOUNTING OFFICE (GAO) REPORTED IN A JUNE 1988 REPORT ("MANY ENFORCEMENT ACTIONS DO NOT MEET EPA STANDARDS") THAT PENALTIES ASSESSED MAY NOT BE LARGE ENOUGH TO

OFFSET ECONOMIC BENEFITS OF NONCOMPLIANCE. GAO COULD NOT DETERMINE WHETHER THE THREE EPA REGIONS COVERED IN ITS REVIEW ASSESSED PENALTIES AS PRESCRIBED BY THE RCRA PENALTY POLICY BECAUSE OF THE LACK OF DOCUMENTATION IN THE FILES. GAO REVIEWED 31 ENFORCEMENT CASES AND FOUND ONLY 2 CASES IN WHICH IT COULD VERIFY THAT THE ECONOMIC BENEFIT WAS CALCULATED IN ACCORDANCE WITH THE PENALTY POLICY.

GAO ALSO REPORTED IN ITS FEBRUARY 1989 REPORT ON INLAND OIL SPILLS THAT FINES WERE RARELY USED. IN FACT, SEVEN OF THE TEN REGIONS HAD NEVER ISSUED PENALTIES EVEN THOUGH THEY HAD FOUND VIOLATIONS OF THE REGULATIONS.

IN ADDITION, MR. CHAIRMAN, WE FOUND THAT THE AGENCY DOES NOT HAVE THE COMPLETE PENALTY INFORMATION NEEDED TO REVIEW ISSUES AND CONCERNS ASSOCIATED WITH THE NEGOTIATION AND ASSESSMENT OF PENALTIES. FOR EXAMPLE, EPA REPORTS DO NOT CAPTURE THE PENALTIES COMPUTED OR ASSESSED, NOR THE MILLIONS OF DOLLARS MITIGATED BY EPA AND DEPARTMENT OF JUSTICE NEGOTIATORS. AS A RESULT, SENIOR MANAGEMENT OFFICIALS CANNOT ADEQUATELY JUDGE THE SUCCESS OF THE PROGRAM NOR FULLY IDENTIFY THOSE AREAS NEEDING IMPROVEMENT.

CAPPING REPORT

LAST WEEK MY OFFICE ISSUED A "CAPPING" REPORT WHICH SUMMARIZES THE PREVIOUSLY ISSUED AUDIT REPORTS ON THE COMPUTATION, NEGOTIATION, MITIGATION, AND ASSESSMENT OF PENALTIES UNDER THREE EPA PROGRAMS; AIR, WATER, AND RCRA. THE REPORT WAS ISSUED TO APPRISE SENIOR EPA MANAGEMENT OF THE RECURRING PROBLEMS

IDENTIFIED IN OUR INDIVIDUAL AUDIT REPORTS. THE AGENCY HAS AGREED TO REEMPHASIZE TO EPA STAFF THE NEED TO FULLY COMPLY WITH ITS PENALTY POLICY, AND TO INCREASE ITS OVERSIGHT OF REGIONAL ACTIVITIES TO ENSURE THAT THE POLICIES ARE FOLLOWED.

CONSTRUCTION GRANTS

THE COMMITTEE REQUESTED THAT I COMMENT ON THE OVERALL VULNERABILITY OF THE EPA WASTEWATER TREATMENT WORKS CONSTRUCTION GRANTS PROGRAM. THAT IS EXTREMELY DIFFICULT. LITERALLY BILLIONS OF DOLLARS HAVE BEEN SPENT IN CONSTRUCTION OF TREATMENT FACILITIES ACROSS THE NATION, AND MOST OF THESE EXPENDITURES HAVE BEEN GOOD ONES. NEEDED FACILITIES HAVE BEEN BUILT AND MOST OF THE COSTS CLAIMED HAVE BEEN APPROPRIATE. IN FACT, ON AN OVERALL BASIS OUR OFFICE HAS ONLY QUESTIONED AROUND TWO PERCENT OF THE COSTS AUDITED.

ON THE OTHER HAND, NOT ALL PROJECTS HAVE BEEN A SUCCESS. IN MANY WAYS THE SUCCESSES AND FAILURES OF THIS PROGRAM TO PROVIDE NEEDED WASTEWATER TREATMENT FACILITIES HAVE DEPENDED ON THE ADEQUACY OF STATE AND FEDERAL OVERSIGHT OF THE CONSTRUCTION GRANTS PROGRAM. SOME STATES AND REGIONS HAVE NOT ALWAYS DONE A GOOD JOB.

FOR EXAMPLE, IN 1986 WE ISSUED AN AUDIT REPORT ON PUERTO RICO'S GRANT PROGRAM WHICH DISCLOSED THAT FIVE REGIONAL WASTEWATER TREATMENT SYSTEMS IN PUERTO RICO COSTING MORE THAN \$200 MILLION WERE NOT OPERATING AND WERE RUSTING AWAY. OTHER MAJOR SYSTEMS WHICH HAD RECEIVED EPA FUNDING FOR PLANNING AS LONG AGO AS 1972 HAD LITTLE OR NO CONSTRUCTION. OVERALL

PUERTO RICO FACILITIES SUFFERED FROM NUMEROUS OPERATION AND MAINTENANCE DEFICIENCIES WHICH GREATLY REDUCED TREATMENT CAPABILITIES. THESE PROBLEMS OCCURRED BECAUSE THE STATE AGENCY CONSTRUCTING AND OPERATING THESE FACILITIES LACKED THE MANAGERIAL, FINANCIAL, AND TECHNICAL CAPABILITY TO OPERATE THE PROGRAM. FURTHER, EPA HAD NOT BEEN SUFFICIENTLY INVOLVED IN GETTING THESE PROBLEMS SOLVED. SIMILAR TYPES OF FINDINGS HAVE SUBSEQUENTLY BEEN DISCLOSED IN REPORTS ON THE VIRGIN ISLANDS AND HAWAII GRANT PROGRAMS.

FROM WHAT WE'VE OBSERVED OVER THE YEARS THE SUCCESS OF THE PROGRAM SEEMS TO RESULT FROM THE COMMITMENT OF THE STATES AND EPA TO SET UP PROGRAMS TO ENSURE THAT:

- (1) GRANT PROJECTS ARE TRULY NEEDED;
- (2) THE FACILITIES ARE APPROPRIATE FOR THE COMMUNITY SERVED AND THE WASTES TO BE TREATED; AND
- (3) FACILITIES BUILT ARE PROPERLY OPERATED AND MAINTAINED.

CONTRACTING

OVER THE PAST SEVERAL YEARS, OUR OFFICE HAS PERFORMED A NUMBER OF AUDITS THAT POINT TO A NEED FOR EPA TO MORE EFFECTIVELY PLAN, MANAGE, AND ADMINISTER ITS MULTIBILLION DOLLAR CONTRACTS PROGRAM.

OFFICE OF POLICY, PLANNING, AND EVALUATION

IN FEBRUARY 1986, WE COMPLETED AN AUDIT ON THE CONTRACTS AND SUBCONTRACTS AWARDED TO SUPPORT THE OFFICE OF POLICY, PLANNING AND EVALUATION (OPPE). IN THIS AUDIT, WE FOUND THAT AGENCY EMPLOYEES EXCEEDED THEIR AUTHORITY AND VIOLATED FEDERAL

PROCUREMENT REGULATIONS IN ADMINISTERING EPA CONTRACTS.

SPECIFICALLY, AGENCY EMPLOYEES INFLUENCED THE PRIME CONTRACTORS' SUBCONTRACTING PROCESSES AND THE DIRECTION OF THEIR WORK EFFORT. OF 211 SUBCONTRACTORS INVOLVED UNDER NINE OPPE PRIME CONTRACTS, 27 WERE ENDORSED OR SUGGESTED BY AGENCY EMPLOYEES. THUS, THESE EPA EMPLOYEES INFLUENCED WHICH FIRMS WOULD PERFORM SUBCONTRACT WORK. SOME AGENCY EMPLOYEES WERE SO CLOSELY INVOLVED IN A WORK ASSIGNMENT UNDER ONE CONTRACT THAT THEY ENCROACHED UPON THE PRIME CONTRACTOR'S RESPONSIBILITY AND PERFORMANCE.

IN ADDITION, WE DETERMINED THAT SUBCONTRACT AWARDS WERE NOT ALWAYS APPROVED BY THE CONTRACTING OFFICER WHEN THEY SHOULD HAVE BEEN AND THAT CONTRACTORS HAD BEEN DIRECTED TO PERFORM ACTIVITIES WHICH WERE OUTSIDE THE SCOPE OF THEIR CONTRACTS. AS A RESULT, THE CONTRACTORS RAN THE RISK OF HAVING ALL OR PART OF THEIR SUBCONTRACTORS' COSTS DISALLOWED BY THE AGENCY. THE AGENCY AGREED TO IMPLEMENT OUR RECOMMENDATIONS. SINCE THAT TIME, THE AGENCY HAS INCREASED ITS CONTRACT MANAGEMENT RESOURCES AND IMPROVED ITS PROCEDURES.

OFFICE OF SOLID WASTE

HOWEVER, IN A REPORT ISSUED LAST MARCH ON MANAGEMENT OF EPA'S OFFICE OF SOLID WASTE CONTRACTS, WE FOUND THAT MANY OF PREVIOUSLY REPORTED PROBLEMS WERE STILL OCCURRING AND FURTHER IMPROVEMENTS WERE NEEDED. SPECIFICALLY, IN MANY INSTANCES CONTRACTORS WERE NOT COMPETITIVELY SELECTING SUBCONTRACTORS. INSTEAD, AGENCY PERSONNEL WERE SELECTING SUBCONTRACTORS AND DIRECTING THEIR WORK. WE ALSO FOUND THAT AGENCY TECHNICAL

PERSONNEL WERE DIRECTING CONTRACTORS TO PERFORM WORK BEFORE IT WAS PROPERLY ORDERED OR FUNDED BY THE CONTRACTING OFFICER. THIS HAPPENED IN ALMOST ONE-THIRD OF THE CONTRACT ACTIONS WE RANDOMLY SELECTED FOR REVIEW. IN ONE INSTANCE, A CONTRACTOR EVEN PERFORMED WORK BEFORE A CONTRACT HAD BEEN AWARDED. THE CONTRACTORS INCURRED APPROXIMATELY ONE-HALF MILLION DOLLARS IN UNAUTHORIZED COSTS.

WE POINTED OUT THAT AGENCY PERSONNEL WERE NOT ADEQUATELY MONITORING CONTRACTORS' WORK NOR WERE THEY APPROVING CONTRACTORS' WORK PLANS UNTIL AFTER SUBSTANTIAL AMOUNTS OF WORK HAD BEEN COMPLETED. WE ATTRIBUTED MANY OF THESE CONTRACT PROBLEMS TO THE FACT THAT PROGRAM OFFICE PERSONNEL LACKED THE NECESSARY TRAINING TO PERFORM THE CONTRACT MANAGEMENT DUTIES THEY WERE REQUIRED TO PERFORM. OVER ONE-THIRD OF THE PEOPLE WE INTERVIEWED HAD NOT ATTENDED THE REQUIRED CONTRACT MANAGEMENT TRAINING.

TECHNICAL ASSISTANCE TEAM

IN SEPTEMBER 1988, WE ISSUED A REPORT ON THE AGENCY'S CONTRACT TO PROVIDE TECHNICAL SUPPORT FOR EPA'S EMERGENCY RESPONSE PROGRAM. WE POINTED OUT THAT PROFESSIONAL PERSONNEL WERE NOT EFFECTIVELY UTILIZED TO PERFORM ESSENTIAL SCIENTIFIC TASKS. INSTEAD ENGINEERS, SCIENTISTS, AND GEOLOGISTS WERE PERFORMING SUCH ADMINISTRATIVE TASKS AS FILE ORGANIZATION, REFERENCING, INDEXING, ANSWERING THE PHONE AND UPDATING LISTS. DURING 1987, \$187,000 WORTH OF SUCH NON-ESSENTIAL WORK WAS PERFORMED BY THESE SCIENTIFIC PERSONNEL. ADDITIONALLY, AGENCY PERSONNEL NEEDED TO IMPROVE THE MANNER IN WHICH THEY GAVE

TECHNICAL DIRECTION AND EVALUATED CONTRACTORS. FINALLY, WE NOTED THAT THE AGENCY DID NOT ALWAYS PROVIDE SUBSTANTIVE COMMENTS TO SUPPORT RATINGS GIVEN TO THE CONTRACTOR WHICH WERE THE BASIS FOR DISTRIBUTING AWARD FEES.

FIELD INVESTIGATION TEAM

IN SEPTEMBER 1988, WE ALSO ISSUED AN AUDIT REPORT ON EPA'S UTILIZATION OF THE FIELD INVESTIGATION TEAM UNDER WHICH A CONTRACTOR PROVIDES COMPLETE PRE-REMEDIAL INVESTIGATION ACTIVITIES, SUCH AS PRELIMINARY ASSESSMENTS AND SITE INSPECTIONS AT UNCONTROLLED HAZARDOUS SUBSTANCES DISPOSAL SITES. WE POINTED OUT THAT BECAUSE OF A LACK OF EFFECTIVE MANAGEMENT OVERSIGHT AT EPA HEADQUARTERS, PROBLEMS IDENTIFIED IN THE REGIONS TOOK UP TO A YEAR TO CORRECT. IN ONE REGION, EXCEPT FOR MOCK EXERCISES TO MAINTAIN FIELD SAMPLING EXPERTISE, THE FIELD INVESTIGATION TEAM SPENT MOST OF THE FIRST YEAR IN THE OFFICE. WE ALSO NOTED THAT EPA NEEDED TO IMPROVE IMPLEMENTATION OF THE AWARD FEE PROCESS IN ORDER TO BETTER ASSESS THE ADEQUACY OF THE WORK PERFORMED BY THE CONTRACTOR. RATINGS WERE OVERGENEROUS AND THE CONTRACTOR WAS PAID AWARD FEES EVEN WHEN WORK WAS LESS THAN SATISFACTORY AND BEYOND THE SCOPE OF THE PRE-REMEDIAL PROGRAM. FINALLY, WE ESTIMATED THAT DURING THE PERIOD OF OUR REVIEW, THE CONTRACTOR CHARGED EPA \$1.1 MILLION FOR TRAINING. WE BELIEVE THE NUMBER OF HOURS CHARGED WAS EXCESSIVE AND IN SOME CASES WASTEFUL.

SINCE OUR AUDITS FOCUSED ON CONTRACTS IN THREE MAJOR PROGRAM AREAS AND IN SEVERAL DIFFERENT GEOGRAPHIC AREAS, WE HAVE CONCLUDED THAT THE AGENCY'S CONTRACT MANAGEMENT PROBLEMS ARE NOT

ISOLATED TO A PARTICULAR PROGRAM, BUT ARE IN FACT WIDESPREAD. ACCORDINGLY, WE WILL CONTINUE TO DEVOTE SIGNIFICANT RESOURCES TO AUDITS OF THE AGENCY'S ADMINISTRATION AND MANAGEMENT OF CONTRACTS.

INVESTIGATIONS

I WOULD LIKE TO COMMENT ON THE MARCH 9, 1989, OPINION OF THE DEPARTMENT OF JUSTICE'S OFFICE OF LEGAL COUNSEL (OLC) CONCERNING THE AUTHORITY OF INSPECTORS GENERAL TO CONDUCT REGULATORY INVESTIGATIONS. IN MY VIEW, THIS OPINION CHOSE THE MOST NARROW POSSIBLE INTERPRETATION OF AN IG'S AUTHORITY AND SO IS UNNECESSARILY RESTRICTIVE.

I CAN SAY UNEQUIVOCALLY THAT I HAVE NEVER HEARD OF ANY INSPECTOR GENERAL WHO WANTED TO TAKE OVER THE REGULATORY INVESTIGATIONS OF HIS OR HER DEPARTMENT OR AGENCY. ON THE OTHER HAND, THERE CLEARLY ARE INVESTIGATIVE MATTERS THAT IGS MUST PURSUE THAT DO NOT FALL NEATLY WITHIN THE NARROW BOUNDS IDENTIFIED BY THE OLC OPINION. THIS OPINION WOULD LIMIT AN IG TO INVESTIGATE ONLY ALLEGATIONS OF FRAUD WASTE OR ABUSE AMONG AN AGENCY'S EMPLOYEES, CONTRACTORS, GRANTEEES AND OTHER RECIPIENTS OF FEDERAL FUNDS OR PRIVATE PARTIES WHO ACT IN COLLUSION WITH AN AGENCY'S EMPLOYEES OR OTHER RECIPIENTS OF FEDERAL FUNDS. THIS INTERPRETATION SEVERELY LIMITS THE BROAD MANDATE IN SECTION 2 OF THE INSPECTOR GENERAL ACT THAT MAKES IT THE DUTY AND RESPONSIBILITY OF EACH IG TO CONDUCT INVESTIGATIONS RELATING TO THE PROGRAMS AND OPERATIONS OF HIS OR HER AGENCY. IT IS MY JOB TO FERRET OUT FRAUD, WASTE, AND ABUSE IN EPA PROGRAMS AND I JUST

DON'T BELIEVE THAT CONGRESS INTENDED ME TO STOP AT THE LIMITS IMPOSED BY THE OLC OPINION.

LET ME GIVE YOU JUST ONE REAL EXAMPLE FROM MY EXPERIENCE AT EPA WHERE A MASSIVE FRAUD WAS BEING PERPETRATED ON THE AGENCY IN A WAY THAT DID NOT INVOLVE FEDERAL FUNDS OR EPA EMPLOYEES. IN 1985, THE NUMBER OF NONCONFORMING "GRAY MARKET" VEHICLES IMPORTED INTO THE UNITED STATES ROSE SHARPLY, FROM FEWER THAN 2,000 IN 1980 TO ABOUT 68,000 IN 1985. MY OFFICE HAD REASON TO BELIEVE THAT MANY FALSE CERTIFICATIONS HAD BEEN SUBMITTED TO EPA CONCERNING IMPORTED AUTOMOBILES THAT HAD ALLEGEDLY BEEN MODIFIED TO CONFORM TO EPA EMISSIONS STANDARDS. EPA'S APPARENT FAILURE TO EFFECTIVELY ENSURE THAT PROPER MODIFICATIONS WERE IN FACT MADE WAS DAMAGING PUBLIC CONFIDENCE IN EPA'S ABILITY TO MANAGE THIS PROGRAM.

DURING 1985 MY OFFICE, UNDER ITS OVERSIGHT AUTHORITY TO MONITOR THE EFFECTIVENESS OF AGENCY PROGRAMS, INITIATED A LIMITED NUMBER OF INVESTIGATIONS CONCERNING ENTITIES INVOLVED IN THE GRAY MARKET VEHICLE IMPORT BUSINESS. IN PARTICULAR, WE SCRUTINIZED CERTAIN MODIFICATIONS SHOPS, TESTING FACILITIES, AND IMPORTERS HANDLING GRAY MARKET VEHICLES. IN DOING SO WE WORKED WITH RESPONSIBLE STATE AGENCIES, SUCH AS THE CALIFORNIA AIR RESOURCES BOARD, AND WITH OTHER FEDERAL AGENCIES, INCLUDING THE FBI AND THE U.S. CUSTOMS SERVICE AND THE OIG OF THE U.S. DEPARTMENT OF TRANSPORTATION. THE RESULT OF THIS COORDINATED EFFORT HAS PRODUCED 73 INDICTMENTS OF INDIVIDUALS AND ENTITIES INVOLVED IN THE GRAY MARKET VEHICLE BUSINESS. IN FEBRUARY 1987 AUTO WEEK

MAGAZINE IN AN ARTICLE ENTITLED "DARK DAYS FOR GRAY MARKET" CREDITED THESE INDICTMENTS AS ONE FACTOR WHICH FORCED MANY IMPORTERS OUT OF THE GRAY MARKET VEHICLE BUSINESS. DURING AND AFTER OUR INVESTIGATIONS THE NUMBER OF NONCONFORMING GRAY MARKET CARS IMPORTED INTO THE UNITED STATES DROPPED FROM ABOUT 68,000 IN 1985 TO ABOUT 5,700 IN 1988, AND ABOUT 1,500 DURING THE FIRST SIX MONTHS OF 1989.

THROUGH THE USE OF INNOVATIVE INVESTIGATIVE TECHNIQUES IN AN AREA THAT THE AGENCY WASN'T MONITORING, MY OFFICE HAS HAD A DETERRENT EFFECT ON THE MASSIVE FRAUD THAT HAD BEEN PERPETRATED AGAINST EPA AND THE PUBLIC. THE RECENT OLC OPINION LIMITING THE OIG'S AUTHORITY TO MATTERS INVOLVING EPA EMPLOYEES OR FEDERAL FUNDS WOULD PRECLUDE MY OFFICE FROM PERFORMING ITS PROPER OVERSIGHT ROLE TO ELIMINATE FRAUD AND ABUSE, SUCH AS WE HAVE DONE IN OUR GRAY MARKET VEHICLE INVESTIGATIONS.

CONCLUSION

THE MANAGEMENT TEAM AT EPA HAS ACKNOWLEDGED THE PROBLEMS I HAVE DISCUSSED THIS MORNING AND INDICATED ITS INTENTION TO TAKE APPROPRIATE CORRECTIVE ACTION. YOU CAN BE ASSURED THAT OUR OFFICE WILL CONTINUE TO PERFORM AUDITS AND INVESTIGATIONS IN THESE AS WELL AS OTHER AGENCY PROGRAMS AND EXPRESS OUR OPINION AS TO THE ADEQUACY OF THE CORRECTIVE ACTIONS TAKEN.

I WILL BE PLEASED TO RESPOND TO ANY QUESTIONS YOU MAY HAVE.



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

NOV 1 1989

THE INSPECTOR GENERAL

Honorable John Glenn
Chairman, Committee on
Governmental Affairs
United States Senate
Washington, DC 20510-6250

Dear Mr. Chairman:

This is in response to your letter of October 17, 1989, concerning several questions by Senator Lieberman regarding my testimony before your committee on October 2, 1989, which included comments on EPA's enforcement activities.

On an overall basis Senator Lieberman's questions seem to focus primarily on the adequacy of action being taken by the Agency and whether congressional action is needed to bring about the needed improvements. In response let me say that the Office of Inspector General is heartened by the positive response and corrective actions proposed by the Agency. We believe that if the Agency effectively implements its planned corrective action, additional legislation will not be necessary.

The enclosure answers each of Senator Lieberman's questions contained in your letter of October 17. Should you or your staff have any further questions, please have your staff contact Ernest E. Bradley III, Assistant Inspector General for Audit, on 382-4106.

Sincerely,

John C. Martin
John C. Martin

Enclosure

Questions from Senator Lieberman

Question 1. In responding to your recommendations, the EPA official in charge of enforcement appears to suggest that the program offices (air, water, etc.) should have the main responsibility to audit the regions to ensure compliance with penalty policies.

Isn't this really a legal review best done by the office responsible for enforcing rather than by engineers or scientists?

Do you believe there is sufficient headquarters oversight on a case-by-case basis in penalty actions?

Answer. We believe the Senator is correct in thinking that reviews to determine adherence to enforcement policy cannot be conducted effectively by only the program offices. In fact, in replying to our draft report on the Computation, Negotiation, Mitigation, and Assessment of Penalties under EPA Programs, EPA's Acting Assistant Administrator for the Office of Enforcement and Compliance Monitoring (OECM) stated that his office will participate in expanded program oversight reviews conducted periodically by each program office. (OECM refers to these reviews as environmental "audits." These "audits" should not be confused with the independent audits conducted by the Office of Inspector General. Rather they are compliance reviews to determine whether EPA's regions are complying with the Agency's penalty policies.)

OECM is required, as part of responding to our audit report, to describe its planned participation in enforcement reviews. Upon receipt, we will evaluate OECM's response to determine whether it is adequate to ensure objective oversight. We will perform necessary followup reviews to determine whether effective oversight reviews are in fact performed.

Additionally, OECM has previously put in place procedures which will permit it to perform oversight on a case-by-case basis. For example, OECM has promulgated a "Model Litigation Report Outline" to be used in each enforcement case. The Outline's purpose is to (1) create a common understanding among Agency personnel and Department of Justice attorneys as to what the litigation report needs to cover, and (2) to make the report's form consistent. By reviewing cases prepared in accordance with these requirements, OECM will be able to review enforcement on a case-by-case basis. We plan to do more work in this area to see if the litigation report outline process is an effective tool for assuring the proper assessment of penalties.

Question 2. You have concluded that EPA is not adequately monitoring compliance with orders and consent decrees under RCRA or permit compliance under the Clean Water Act. Is this lack of oversight (or inaccurate oversight) due to lack of training, inadequate resources, inefficiency, or other factors? What steps do you recommend to address these problems?

Answer. We think additional training is necessary to be able to adequately monitor both RCRA consent agreement/final orders (CA/FO) and permit compliance under the Clean Water Act. In reply to our reports relating to these two areas, Agency staff stated that they plan to develop guidance to correct the deficiencies reported. Some form of training will be needed for staff who are responsible for implementation of the guidance.

The conditions disclosed during our RCRA regional reviews related to untimely compliance, inadequate technical compliance, or a lack of violator response to CA/FO provisions. The conditions were attributable to one or more of several causes including:

- CA/FOs frequently lacked penalties for noncompliance.
- Program officials failed to conduct timely followup site inspections to assure compliance.
- CA/FO terms and conditions were often weak.
- Unauthorized or undocumented CA/FO modifications were made by regional staff.
- Regional operating policies, procedures and tracking systems were not fully adequate.
- Regions did not maintain post-order compliance files on violating facilities.

In our report, Review of EPA Controls Over Compliance Monitoring of RCRA Enforcement Program Consent Agreements, dated March 17, 1989, we recommended that the Assistant Administrators for OECM and the Office of Solid Waste and Emergency Response (OSWER):

1. Institute a more aggressive oversight program of regional CA/FO activities.
2. Publish guidance directed at regional standards for monitoring CA/FO provisions and maintaining post-order compliance files.

3

3. Designate an effective automated regional CA/PO tracking system that can be uniformly implemented by the region to improve compliance monitoring activities.

OSWER and OECM agreed with our recommendations, and have begun initiating corrective actions. We will in the future of course, conduct followup reviews to determine whether the actions have been sufficient to rectify the problems.

Regarding permit compliance under the Clean Water Act, in our September 15, 1988, report NPDES Compliance Monitoring Information, we concluded that noncompliance data being reported by states and regions in their Quarterly Noncompliance Reports (QNCR's) were not always complete or correct. In our report we stated that EPA regions and states must take responsibility for the accuracy of the noncompliance data being reported. We also stated that Headquarters must provide the necessary oversight to ensure the completeness of the information in the system.

In response to our report, the Agency agreed that the regions and states must take responsibility for the accuracy of the data, and that increased Headquarters oversight should be conducted. They also stated that a permanent program to review QNCRs is being established and a quality assurance guide is being developed for regions to use to conduct quality control on EPA and state generated QNCRs. If the Agency implements these programs, the quality of the noncompliance data should improve.

Question 3. You have emphasized in your report that EPA in many of its settlements has not recovered the full amount of economic benefit -- the costs of non-compliance -- from a violator. Yet under the environmental statutes, Congress has provided that the courts, in setting a penalty, should consider many factors, including financial hardship, good faith efforts, etc. And Congress has not set forth a minimum amount of penalties which the court must award.

Do you recommend that Congress reexamine these penalty provisions and eliminate these discretionary factors?

Answer. We don't think it is necessary at this time for Congress to reexamine the penalty provisions regarding deductions from penalty calculations for such factors as financial hardship, good faith efforts, etc.

What is needed is more aggressive action by Agency personnel in following the existing policies. We found in many of our reviews that economic benefits were not even calculated.

Further, gravity based penalties were not always reflective of the seriousness of the violations, duration of noncompliance, nor the number of violations found. We believe that all these factors need to be considered in computing the initial proposed penalty assessment.

Once this is done, the Agency can and should consider other factors in deciding whether to mitigate or reduce the penalty assessment. The Agency then should give appropriate consideration to financial hardship, good faith efforts, etc., in determining the final penalty. However, such consideration should be done in accordance with the provisions of the established Agency penalty policies and should be appropriately documented so that Agency management and the public can be assured that such adjustments were fair and reasonable.

In our opinion, the Agency has recognized the need for improving their penalty assessment process and has the capability of solving these problems without additional legislation. You can be sure that we intend to continue performing reviews in this area and will update our reports as to the adequacy of corrective action.

Question 4: I am told that EPA attorneys usually arrive at an initial penalty figure without consultation with the Justice Department. The litigators therefore, have not had their input regarding the litigation risks of the case. Do you think this type of input is important before EPA arrives at an initial penalty collection?

Doesn't this input become especially important if you are comparing the original penalty figure with the amount ultimately obtained and using that as a measure of success or failure?

Answer. We do not think that input from the Department of Justice (DOJ) is necessary during the preliminary computation of the initial proposed penalty assessment. EPA attorneys at the regional level could readily compute this amount based on the evidence developed and established Agency penalty policies. Available documentation should describe the basis for determining penalty amounts assessable for the violations found, along with appropriate justifications and documentation in arriving at the initial proposed penalty. Unfortunately, as our recent audits have shown, regional offices have not been properly computing or documenting either the basis for the proposed penalties or the reductions they have made in coming up with the initial proposed penalty.

Once this initial assessment is made, resulting information about the violations, supporting evidence, and the inadequate or incomplete data about the proposed penalty have been submitted to both the EPA attorneys in Headquarters and to DOJ. This information along with DOJ input on such items as litigative risk are used in negotiations with the violators. We believe that the current system does provide for adequate consideration of litigative risks, however the inadequate or incomplete information available about the computation of the initial proposed penalty clearly hampers the ability of attorneys to negotiate from a basis of strength.

In instances where appropriate and complete documentation is maintained showing the basis for penalty composition and the necessity for and reasonableness of any reductions, there should be no problem in comparing the amounts originally proposed with the amounts ultimately obtained. Unfortunately, EPA does not maintain such records. This prevents not only our office but also EPA managers at all levels, including those who directly supervise attorneys from being able to assess the reasonableness of EPA settlements.

Question 5. Most of EPA's environmental programs are largely delegated to the states. Yet the states are not bound to follow the penalty policies.

Isn't one of the primary purposes of the penalty policies -- to send a uniform message to the regulated community -- sharply diminished because the states are not required to follow the policies? Do you recommend that the states be required to follow the policies as part of delegation of a program?

You recommend that EPA audit the states. What is this audit intended to examine if the state are not required to follow the policies?

Answer. Some of our issued reports show that regional oversight or even knowledge of state penalty practices is almost nonexistent. We believe it is essential for EPA to know what these practices are. We recommended in our capping report that the regions institute a regional reporting and oversight program on state penalty assessment activities to ensure that proper penalties are levied.

EPA's Office of Water has already started to require reporting of state penalty data. The Office of Water plans to work with OECM during FY 1990 to develop a plan for assessing state penalty practices.

We plan to work with OECM to encourage other media offices to implement similar programs. After this information has been accumulated and assessed, a determination can be made on whether the regions can work effectively with the states to ensure penalties are in line with the various media laws, or whether the states should be required to follow EPA penalty policies as part of the delegation of programs.



THE DIRECTOR

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

INTRODUCTORY STATEMENT
(Concerning the "M" in OMB)

PRESENTED BEFORE

THE SENATE GOVERNMENTAL AFFAIRS COMMITTEE

BY

RICHARD DARMAN

DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

OCTOBER 5, 1989

INTRODUCTORY REMARKS

Thank you, Chairman Glenn, Senator Roth, and distinguished members of the Committee, for inviting me to testify today. It is a pleasure to be with you to discuss efforts to improve the management of the Federal Government. During my confirmation hearings, I welcomed Senator Glenn's invitation to return after six months and "testify as to where we stand with the 'M' in OMB." That is my purpose in being here today.

With your permission, I would offer a few summary points orally, and then ask that the remainder of this prepared introductory statement be included in the record.

In short:

- o (1) The management problems of the Federal government are enormous. Whether governmental performance is better or worse than the private sector's -- after adjusting for differences of scale -- is arguable. But that is irrelevant. The governmental management problems are more than serious enough to merit greater attention. Indeed, they present not only issues of efficiency and integrity; but also issues that ultimately can affect the basis for confidence in democratic government.

- o (2) The recently-exposed HUD problems are not unique, not merely peculiar to a particular agency under what some have described as absentee management. Nor are they peculiar, as some have suggested, to the so-called "greed decade," the Eighties. There are analogous problems in other agencies. And the history of such problems is at least as old as the American government itself. This is not to try to diminish the significance of such problems. It is, rather, to suggest that we must address them as at least partly systemic.
- o (3) Among the systemic problems are: failures of basic information and control systems and failures of collective oversight. These stem, in part, from the inherent complexity of large-scale government. But they derive also from what seems to me to be part of a Washington cultural problem. I call it the "Hollywood East Syndrome." There are too many people in positions of political responsibility who are infatuated by the lure of glitter and lights -- or the often-illusory chance to "make policy." And, as it happens, there are too few top-level people who are interested in -- and too few local rewards for -- the more pedestrian work of nuts-and-bolts management.
- o (4) There is enough blame to go around widely; and OMB must share in the blame. Notwithstanding the best of intentions, the "M" in OMB has suffered from too little attention over the years -- too little attention within OMB, within the Executive Branch, and within the Congress. It has also suffered from too little in resources. At the same time, however, OMB has a significant role -- and responsibility -- in trying to help reduce the problems that failures of collective oversight, including its own, may have produced. We are trying to improve our capacity to meet that responsibility -- in ways that my prepared statement touches upon and that I will be happy to discuss.

The remainder of my introductory statement is divided into three parts: a brief history of Federal management problems and efforts to remedy them; an overview of selected reasons for the mixed results of those efforts; and a description of our current approach to improvement and reform. I ask that the remainder of this statement be included in the record, and would be pleased to try to respond to your questions.

SUPPLEMENT FOR THE RECORD

I. SYNOPSIS OF HISTORY RE MANAGEMENT PROBLEMS

There have been highly visible problems in Government management since the beginning of the Republic.

- As early as 1778, there were evident problems in Army procurement. The scandals of the Grant Administration in the mid-19th Century and the Harding Administration in the Twenties are often featured in history books. These are merely the scandals that are remembered. Unfortunately, there have been countless others.
- Given the recent problems at HUD, it is worth recalling earlier difficulties with housing programs. In 1954, the then-Commissioner of the Federal Housing Administration had to resign; he knew of abuses in the area of home improvement loans but did not act to correct them. Notwithstanding this embarrassment, two years later, in May 1956, Congressional hearings indicated that problems in FHA continued.
- In 1963, during the Kennedy Administration, a selection of 75 GAO reports on Federal contracting revealed irregularities aggregating \$300 million in unnecessary expenditures. Today, we still lament such regrettable waste.
- In view of the current attention to FDA, it is interesting to note that, during the Johnson Administration, Senator Ribicoff lambasted the Food and Drug Administration for being an "administrative quagmire" and failing to protect the public. Notwithstanding this blast, the FDA was still making mis-management news in 1969 at the beginning of the Nixon Administration, as it is today.
- Problems at DOE today lead one to recall that, in 1975, the Federal Energy Administration was accused of not enforcing its rules to prevent overcharges for oil of up to \$1 billion. And, in view of current questions about delinquent loans, it is noteworthy that this Committee concluded after an investigation in 1976 that the then Office of Education had "been less than efficient in its administration" of the student loan program.

- In the Carter years, the topical discoveries were pervasive corruption in the General Services Administration; manipulation of energy data to further policy objectives; and massive cheating in the National Direct Student Loan Program.
- In short, management problems are not new. The history of problems may be a sorry one; it is in any case a long one.

There have also been efforts at management reform since the beginning of the Republic.

- The Congress appointed an Inspector General in 1778 to deal with the problems of the Continental Army. In the late 19th Century, the Pendleton Act created a Civil Service and the Dockery Act established auditors in Treasury to examine government accounts and the disbursement of public moneys.
- Since World War II, a variety of Commissions have addressed the problem: the first and second Hoover Commissions in 1950 and 1955, the Heinemann Commission in 1967, and the first and second Ash Councils in 1970 and 1973. Each of these recommended re-organization and management improvements. The problems continued.
- The Executive Branch initiated a number of management systems in the Sixties and Seventies: Planning Programming and Budgeting (PPB) in the Johnson Administration, Management by Objectives (MBO) in the Nixon Administration, Presidential Management Initiatives (PMI) in the Ford Administration, and Zero Base Budgeting (ZBB) in the Carter Administration. Whatever their theoretical merits, none of these central systems really took hold.
- The Congress has enacted reforms. Among these have been: the Budget and Accounting Acts of 1921 and 1950; the Civil Service Reform Act of 1978; the Inspector General Acts of 1978 and 1988; the Office of Federal Procurement Policy Acts of 1974, 1979, 1983 and 1988; the Paperwork Reduction Act of 1980; and the Federal Managers Financial Integrity, Prompt Pay and Debt Collection Acts of 1982. Yet problems persist.

Although the "M" in OMB is relatively new, OMB has, from its beginning, been involved in attempts to improve Federal management.

Section 209 of the Budget and Accounting Act of 1921 specifically provided OMB's predecessor Bureau of the Budget (BOB) with authority to assist the President in deciding on organizational issues. However, most of the early Directors of BOB viewed BOB as an instrument of economy rather than management improvement. And so, the budget review process tended to focus exclusively on management initiatives that identified ways to reduce spending rather than on those that invested in future improvement.

Except for a brief period during World War II, OMB's predecessor BOB devoted little time and developed little capacity to deal with management issues. This changed in theory with the Reorganization of BOB into OMB in 1970, but the history of the Nixon, Ford and Carter years was marked more by fits and starts than by sustained efforts which could achieve long term improvement.

The Reagan Administration's OMB gave a relatively high priority to management improvement in an initiative called Reform 88. But GAO's review of Reform 88 published in May 1989 found that, while the Reagan OMB had achieved some success in a number of administrative areas, the broader issues of policy implementation and program service delivery had not been adequately dealt with. Further, GAO argued that the work of OMB has been dominated by its budget activities and that Reform 88 did not provide a framework for broader management improvements. I agree. We also agree that more needs to be done in the areas of credit management, improved financial management systems, and procurement reform. I said this at the time of my confirmation hearings before this Committee. The point seems even more clear and compelling to me today.

II. OVERVIEW OF EXPLANATIONS FOR PERSISTENT PROBLEMS

While the history of management improvement efforts shows mixed results, it is unclear whether the continuing problems of Federal management are disproportionate to the size of the governmental enterprise.

- The Federal government today spends 22.5 percent of GNP. It is larger than 100 countries' entire GNP combined.
- A review of management problems points out areas of especially high risk: large numbers of transactions and large cash flows; broad and inadequately supervised delegations; excessively decentralized program execution; inadequate information and systems on which to base decisions

and provide for oversight; programs, which by their very nature, risk physical and environmental damage; programs in startup; programs targeted for termination; programs subject to frequent legislative change; and inadequate attention to management by the political leadership. Many -- not all -- of these are a function of scale. That is, to some degree they may inhere in any large decentralized system (or any large centralized system, for that matter).

- In concentrating on problems, we tend to forget that the vast majority of Government activity is without reproach. We, of course, wish that the record were still better -- much better. That is easy to say. What is harder to judge is the realistic standard that one should expect to achieve.
- Complicating this issue a bit further is this consideration: While we know the current nature of the problems of Federal management, we have no meaningful baseline with which to compare these currently observed problems. We have no reliable idea as to whether the number of incidents and/or the aggregate amounts of government mismanagement are going up, down, or remaining the same in relation to the size of government. We also do not know whether the Federal government is worse, better, or the same as other governments or private industry in these respects.

Notwithstanding these difficulties in understanding where we really are, we might speculate about a few basic reasons for the mixed results of past efforts to improve Government management.

First, as suggested above, the extraordinary size of American Government makes it difficult to manage. There must, of necessity, be substantial delegations of authority. And delegations in any organization pose risks. These risks can be reduced by appropriate oversight and control systems. But, for a variety of reasons, such systems have suffered from an ironic combination of under-attention (producing laxity) and over-attention (producing confused accountability).

Second, the political leadership, both in the Executive Branch and the Congress, tends not to be interested in management. The conspicuous exception to this general observation concerns pinpointing blame for scandals. The political system rewards this behavior. But the careers of

few political leaders have been made in developing management systems and improving personnel practices. There is a related problem of expectations in the selection (including self-selection) of top level policy and program leaders. Heads of agencies, Deputy heads of agencies, and program directors are rarely chosen for, explicitly charged with, or generally held accountable for, "management" in the nuts-and-bolts operational sense.

Third, short-term budget objectives have tended to override interests in the management efficiencies of multi-year procurement and longer term investment, whether in physical or human capital. This has been a problem for the modern OMB -- as it was for its predecessor, BOB.

Fourth, there is the problem of the short tenure of political level Federal managers. The average term in office of political appointees is now two to three years. New administrations, and their political appointees, want to set their marks, develop their own programs, and advance "initiatives" in their own, relatively short time-frames. There is little building across the successive waves of leadership, and less attention to the invisible returns from which successors might benefit. The pattern of fits and starts -- troublesome in its own right -- has also led to some cynicism or demoralization on the part of those who must carry out the effort.

Any would-be successful approach to reform must take these systemic tendencies into account -- both in attempting to counter them, and in being realistic about limitations.

III. CURRENT APPROACH TO MANAGEMENT IMPROVEMENT

MANAGEMENT BY OBJECTIVES

Given the scale and complexity of government it is impossible for top level management to track and oversee everything. A selective oversight process is inescapable. The key is to make selective oversight intelligent, meaningful, and effective. With this objective in view, we have established a relatively simple management by objectives system for use by managers -- starting with the President.

In his February 9, 1989, Budget Message to Congress, the President highlighted his intention to establish a Management by Objectives (MBO) system to track selected policy initiatives and priorities from the time of their formulation and announcement to their ultimate outcomes.

The purpose is to provide focus on priorities and then assure that necessary resources and oversight are devoted to achieving them.

In April, the President met with the Cabinet on MBO's and requested each Cabinet Secretary, and later the Administrators of the Environmental Protection Agency and the National Aeronautics and Space Administration, to submit three to five candidate objectives they believed should be major priorities. The President informed department and agency heads of his selection of objectives in July. The tracking process is now underway -- on a basis that will be integrated with the Budget in January.

The President's MBO system includes policy, program and management objectives. In addition to specific departmental and agency objectives, the President has also established a number of cross-cutting priorities: in management areas, literacy, drugs, trade and export promotion, and R&D. While the majority of the departmental and agency objectives are policy and program related, many of the agencies also have significant management objectives. Examples include the Department of Defense's management reform effort (which was requested by the President) and the Department of Energy's clean-up at its nuclear weapons facilities.

There are clearly pitfalls in any MBO system. The Nixon MBO system was originally conceived as "top down," but it rapidly became a "bottom up" process of bureaucratic consensus and paperwork without content. The system grew and then atrophied. Except in HEW and Interior, the MBO system was substantively dead by 1974. President Ford revived MBO's as Presidential Management Initiatives (PMI) in 1976. PMI was designed to elicit objectives that agency heads personally wanted. But PMI suffered from the same problems that beset the Nixon MBO system. It degenerated into a substantial paperwork burden and was abandoned in the Carter Administration. Our intention -- and hope -- is to keep the MBO system simple, in order to keep it relevant. If we do not keep it simple, I fear it will go the way of its predecessors.

LONG TERM VS. SHORT TERM

In his February 9 Message, the President instructed OMB to devote more effort to anticipating long term problems and opportunities and to develop ways of highlighting those elements of annual federal expenditure that are in the nature of capital outlays. We are working on this in developing our approach to the FY 91 Budget.

We share GAO's concern that current Federal accounting principles are biased against longer term investment. We are considering carefully GAO's capital budget proposals. As you know, Special Analysis D provides a summary of the Federal Government's investment and non-investment accounts. The practical issue is: how can we give greater weight to longer term needs without opening the door to gimmickry that would make sensible fiscal restraint even more difficult?

FINANCIAL MANAGEMENT

The financial management systems of the Federal government have not kept up with the growth and complexity of government operations. As examples --

- We were unable, during the recent deliberations on funding for the President's drug eradication program, easily to provide current data on unobligated balances. We were forced to collect data from a large number of disparate agency systems, including manual extraction of data from program and regional offices.
- We are often unable to aggregate information in ways that permit meaningful programmatic conclusions across agencies. It is, for example, impossible easily to compare unfunded liabilities of Federal credit programs or to track debt collection efforts (administratively and in terms of legal process).
- Inventory and receivables systems are often unable to assure adequate controls.

Improved financial management systems are essential if we are to achieve oversight of the necessarily large delegations of authority in the Federal enterprise.

The Joint Financial Management Improvement Project (JFMIP) -- of which the Secretary of the Treasury, the Comptroller General, the Director of the Office of Personnel Management, and I are the principals -- has helped advance financial management improvement efforts over the years. It assisted in simplifying central funding practices in the Fifties, modernizing auditing techniques and providing for letters of credit in the Sixties, simplifying intra-governmental billing and collections in the Seventies, and implementing the single audit in the early Eighties. In January 1988, JFMIP published the Core Financial System Requirements document.

The Reagan Administration's Reform 88 also stimulated financial management improvements: in cash and credit management, financial systems improvements (particularly in the payroll area), technology improvements (particularly in the Internal Revenue Service), and interagency coordination (in cross-servicing and in the Chief Financial Officer Council).

For the future, we plan --

- to upgrade the OMB and Treasury central systems (STAR and MAX) and move toward a single, government-wide network of financial management systems;
- to pursue cross-servicing arrangements whereby agencies with well-functioning financial management systems might provide services to those that do not have such systems;
- to develop government-wide loan delivery and credit management systems -- to serve the public better, reduce costs, and provide more accurate and timely information about the performance and costs of each lending program;
- to expand the use of private attorneys to assist the Department of Justice in the collection of debt owed the United States, and encourage access to HUD's credit alert system which allows prescreening of direct and guaranteed loan applicants' credit-worthiness; and
- to improve service to recipients of Federal benefits, such as through automated teller machines.

At the suggestion of the Comptroller General, I recently convened a meeting of JFMIP principals to discuss the JFMIP agenda for the future. We agreed:

- to accelerate, wherever possible, the work already underway to improve Federal financial management;
- to implement the Core Financial Systems Requirements document issued by JFMIP in 1988 (agencies will be certifying their levels of compliance in their FY 89 reports due this December under the Federal Managers' Financial Integrity Act); and

- to develop and implement standard terms and definitions for financial information and minimum uniform financial information requirements.

PERSONNEL MANAGEMENT

We must, as stressed by the Volcker Commission, rebuild the public service and the public's trust in it. We must improve both the image of public service and provide for competitive pay to attract and retain for the country's largest employer its fair share of the best and the brightest. We must link pay and performance.

The President recognizes the importance of Federal—military and civilian personnel to achieving the Government's mission and objectives.

- In his first speech in office, the President told the Senior Executives "the success of any political leadership in implementing its policies and objectives depends heavily upon the expertise, quality and commitment of the professional career employees of government."
- The President has proposed legislation to provide for salary increases for senior executives (up to 25 percent), as well as higher pay (up to Cabinet level) for certain critical positions.
- In line with the recommendations of the Packard Commission and Secretary Cheney's recent management report, the President has also approved personnel reforms in DOD to improve the quality and productivity of acquisition personnel.
- The Administration is working with Congress to achieve the President's legislative objectives and to expand authority for demonstration projects to test innovative pay concepts.

In the longer term, we will propose next year:

- a comprehensive pay reform proposal to provide for greater flexibility and to make pay more sensitive to local market rates; and
- a comprehensive reform of the Federal Employees Health Benefits (FEHB) program to put the program on a sound and more cost-efficient footing.

GOVERNMENT MANAGEMENT AND INTEGRITY

While it may have been the Billy Sol Estes case that stimulated the first domestic Inspector General at the Department of Agriculture in 1962 -- the State Department has had an IG since 1906 -- it was this Committee and the House Committee on Government Operations which pioneered the Inspector General Act of 1978 and the 1988 amendments to that Act. I am entirely sympathetic with your efforts in this respect, and congratulate you for them.

The Bush Administration puts great value on the Inspectors General. We determined that resignations would not be requested from Presidentially appointed Inspectors General and that, subject to individual review by incoming department and agency heads, the presumption would be that PAS Inspectors General would stay on (unlike any other Presidential appointees). I am pleased to report that nine Inspector General incumbents are being retained; that selections have been made to nominate individuals to fill three vacancies as a result of retirement or transfer; and that interviews are underway with respect to three other vacancies as a result of retirement or transfer. Decisions on two incumbents are pending appointment and confirmation of the head of agency. Of the five new PAS IG positions established by the 1988 IG Act Amendments, one has been announced and interviews are under way with respect to the remaining four. Of the 33 non-statutory IGs authorized under the IG Act Amendments of 1988, 27 have now been appointed.

Let me turn to the general question of Federal management and integrity. The HUD problem became highly visible in June. It involved four major program areas: the moderate housing rehabilitation program, closing agent cash management, the FHA multi-family co-insurance program, and the Title X Land Development Insurance program. The problems in these areas included non-competition and political influence, over-payments, embezzlement, high default rates and politically motivated insurance underwriting. Most of these problems were reported by the HUD IG and in reports under the Federal Managers' Financial Integrity Act -- in the case of the moderate housing rehabilitation program as early as 1983.

Upon assuming office, we also became aware of major environmental and safety problems involving the Department of Energy's nuclear weapons plants. Again, several major reports over the last seven years had shown that problems were accumulating in these plants. DOE internal operating and management practices had not kept pace with changing environmental requirements; and oversight systems had not

satisfactorily penetrated a traditionally closed culture within DOE's weapons complex. Secretary Watkins has developed a reasonable five-year clean up plan, which we have supported strongly.

Concerned that the Bush Administration take immediate action in all these areas -- and that IG reports, audits and internal control reports be taken seriously -- I called a White House meeting of Deputy Secretaries and the Deputy Administrators of EPA and NASA on June 23. I told the Deputies that we wanted them personally to work with their IGs, Assistant Secretaries for Management and Chief Financial Officers and to assess their internal control and audit followup programs and report back.

Our Executive Associate Director, Frank Hodson, requested similar reports from the smaller agencies on July 14. And our Deputy Director, Bill Diefenderfer, met one-on-one with each IG in July and August to review their concerns.

The reports of the Deputies are in. Our staff has reviewed them and developed with the agencies lists of highest risk items. Our purpose is to obtain agreement on the most vulnerable areas and then devote significant attention to correcting those vulnerabilities over time. OMB will track these highest risk areas, and I have instructed OMB budget staff to give priority to providing resources to needed corrections. Improving management and integrity is also being tracked as a key objective in the President's MBO system. Responsibility for this objective has been given to the President's Councils on Integrity and Efficiency and Management Improvement, both chaired by OMB.

STRENGTHENING OMB'S CAPACITY TO MANAGE

As I stated at my confirmation hearings, OMB's record in providing leadership and direction in the management area has been mixed. GAO's May 1989 report is accurate in this respect.

From the start of my tenure, I have tried to make clear my commitment to strengthening OMB's management capacity. I established the position of Executive Associate Director for Management. I requested from our Appropriations Committees additional staff resources for management (an area that had suffered from bureaucratic atrophy). Internally, we have instructed our budget staff to take into account the objectives in the President's MBO system, as well as other

management improvement needs, in developing the President's FY 91 Budget. We are committed to assuring, within budget constraints, adequate resources for management improvement.

We completely concur with the May GAO report that there is a need for better integration of management and budget functions. We are making special efforts to achieve this objective. We also support GAO's recommendation that a Deputy Director for Management be created within OMB to direct and coordinate OMB's management oversight functions.

Finally, please let me add that we welcome this Committee's interest in exercising its important oversight responsibility. We view it as complementary to our own. We are happy to try to cooperate with the Committee -- and look forward to continuing to do so.

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Significant Management Problems Identified at Governmental Affairs Committee Hearings

Poor Systems Development & Acquisition Practices

- HCFA's procurement of over \$500 million system for Medicare drug benefit which won't work.
- State's failure to identify requirements for major telecommunications and information system procurements.

Forceless Enforcement

- No criminal enforcement of ERISA, OSHA, and wage and hour laws.
- Untold millions in reduced EPA fines, without documentation.

Poor Contracting Practices

- DOE contracts permit payment for thefts and otherwise 'unreasonable' costs.
- Too many examples of no competition in contracting at NASA, DOD, and EPA.
- DOE contract indemnification policy encourages poor management at nuclear weapons facilities.
- DOD's 'laundering' funds through DOE labs and Library of Congress to avoid procurement laws and regulations.

No Controls on Contracted Advisory and Assistance Services (Consultants)

- NASA's contracting out for critical functions, and inadequate contract administration resources.
 - DOD failure to properly identify and control consultants.
- ### **No Internal Controls**
- \$400 to \$900 million overpayments in Medicare secondary payer program.
 - NASA's inability to adequately manage procurements (88% of its budget).

Problems for Inspectors General

- Failure of White House to fill IG vacancies expeditiously.
- Administration's mishandling of IG reappointments.
- Justice Department's compromising IG investigative authority (e.g., interferences with investigations of visa fraud and Social Security card fraud).
- Twenty-two year audit cycle for NASA programs because of limited IG resources.

SUNDAY, SEPTEMBER 17, 1989

THE WASHINGTON POST

WANTED

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UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

JUN 23 1989

OFFICE OF
SOLID WASTE AND EMERGENCY RESPONSE

MEMORANDUM

SUBJECT: Request for No Cost Extension/Justification for Other than Full and Open Competition for the Sobotka and Company, Inc., - Contract Number 68-01-7332

FROM: Susan E. Bromm, Director *Susan E. Bromm*
RCRA Enforcement Division

TO: David J. O'Connor, Director
Procurement and Contracts Management Division

Attached is a Justification for Other than Full and Open Competition (JOFOC), for a Justification of Sole Source Acquisition of Services for the Sobotka and Company, Inc., contract. The extension of the period of performance is for three months with a two month option period to provide continual technical support and background analyses to support EPA's Corrective Action Resource Conservation and Recovery Action (RCRA) and the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA).

The Sobotka contract will expire on July 9, 1989, with no contract vehicle to transition headquarters projects that are being conducted under this contract. The new contract for the Office of Waste Programs Enforcement-RCRA Enforcement Division (RED) is scheduled to be awarded mid-October 1989. RED had originally scheduled an award to an 8(a) firm, MAE-CORP, to replace the current contract. This company, however, had failed to notify the Agency that it had graduated from the 8(a) program. The Chicago Small Business Administration (SBA) office had also neglected to inform the Agency. MAE-CORP's RFP package had been technically reviewed and had cleared the Audit for an award when the SBA in Washington informed the Agency of the ineligibility of MAE-CORP, and forced the program office to seek a full and open competition. Because of MAE-CORP's ineligibility, the Agency was forced to recompile the current requirement and is now requesting an extension to the current contract. For this reason, beyond

-2-

the immediate control of RED, it has become necessary to request a no cost extension to cover the period between the expiration date, July 9, 1989 and the anticipated award date of a successor contractor mid-October 1989.

Without the Sobotka contract for enforcement support, and until the award of the successor contract, the RED program will be unable to conduct the following tasks:

- 1) RCRA Enforcement Policy for case development, data collection and analysis, and implementation of the RCRA enforcement policies;
- 2) Strategic Planning and Management System (SPMS) data support and Regional Facility Reviews and analysis in preparing Timely and Appropriate Enforcement Reports to the Administrator;
- 3) Provide technical and analytical data in the development, evaluation and review of RCRA compliance monitoring and enforcement data support to OWPE;
- 4) RCRA/CERCLA Interface to provide assistance in the development of regulatory enforcement guidelines and present findings of State Hazardous Waste Enforcement Study and provide improved oversight and evaluation of State programs;
- 5) Subtitle D - developing enforcement recommendations and strategies for the Subtitle D regulation;
- 6) Land Disposal Restriction Guidance - develop a compliance monitoring and enforcement program for the First Third;
- 7) Information on State Corrective Action - To gather information on State Corrective Action Programs and Authorities and provide concise description of relevant state programs for CA activities at hazardous waste facilities. It is imperative that this JOFOC for the extension of the period of performance of the Sobotka Company, Inc., contract be approved immediately.

The attached JOFOC fully describes the existing responsibilities of this program office that are of an unusual and compelling urgency. Without a contract vehicle, the RED Corrective Action and Compliance Monitoring and Enforcement Program will be compromised in delivering much needed RCRA/CERCLA regulatory and implementation support in enforcement to OWPE, Regions and States.

-3-

Because the current contract expires July 9, 1989, we would appreciate your consideration of this request as soon as possible, and are available to provide you with further information concerning this matter. If you have questions, please have your staff contact Estelle Bulka on 475-9324.

Attachment

cc: Sandi Jones

38848

Proposed Rules

Federal Register

Vol. 54, No. 188

Wednesday, September 27, 1989

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices

is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

(PS-217-84)

RIN 1545-AM49

Golden Parachute Payments

AGENCY: Internal Revenue Service, Treasury.

ACTION: Correction to notice of public hearing on proposed regulations.

SUMMARY: This document contains a correction to the notice of public hearing on proposed regulations relating to golden parachute payments.

FOR FURTHER INFORMATION CONTACT: Angela Wilburn, (202) 508-3835 (not a toll-free number).

SUPPLEMENTARY INFORMATION

Background

On September 13, 1989, the Federal Register at 54 FR 37815 published a notice of public hearing on proposed regulations under section 280(G) of the Internal Revenue Code of 1986.

Need for Correction

As published, the notice of public hearing did not include the beginning time of the public hearing.

Correction of Publication

Accordingly, the publication of the notice of public hearing in the Federal Register for Thursday, September 13, 1989, at page 37815, column 1, under the subheading "DATES", the paragraph should read: "The public hearing will be held on Friday, November 17, 1989, beginning at 10:00 a.m. Outlines of oral comments must be delivered by Friday, October 27, 1989."

Dale D. Gooda,

Chief, Regulations Unit, Assistant Chief Counsel (Corporate).

[FR Doc. 89-32740 Filed 9-28-89; 9:45 am]

BILLING CODE 4810-01-2

26 CFR Part 1

(PS-802-89)

RIN 1545-AM82

Research and Experimental Expenditures

AGENCY: Internal Revenue Service, Treasury.

ACTION: Correction to notice of public hearing on proposed regulations.

SUMMARY: This document contains a correction to the notice of public hearing on proposed regulations relating to research and experimental expenditures.

FOR FURTHER INFORMATION CONTACT: Angela Wilburn, (202) 508-3835 (not a toll-free number).

SUPPLEMENTARY INFORMATION

Background

On September 14, 1989, the Federal Register at 54 FR 37947 published a notice of public hearing on proposed regulations under sections 41 and 170 of the Internal Revenue Code of 1986.

Need for Correction

As published, the notice of public hearing did not include the beginning time of the public hearing.

Correction of Publication

Accordingly, the publication of the notice of public hearing in the Federal Register for Thursday, September 14, 1989, at page 37947, column 2, under the subheading "DATES", the paragraph should read: "The public hearing will be held on Tuesday, December 5, 1989, beginning at 10:00 a.m. Outlines of oral comments must be delivered by Friday, November 17, 1989."

Dale D. Gooda,

Chief, Regulations Unit, Assistant Chief Counsel (Corporate).

[FR Doc. 89-32741 Filed 9-28-89; 9:45 am]

BILLING CODE 4810-01-2

ENVIRONMENTAL PROTECTION AGENCY

48 CFR Part 721

(OPTS-50573; FRL-3851-3)

2,4-Pentanedione; Proposed Significant New Use of a Chemical Substance

AGENCY: Environmental Protection Agency (EPA).

ACTION: Proposed rule.

SUMMARY: EPA is proposing a significant new use rule (SNUR) under section 5(a)(2) of the Toxic Substances Control Act (TSCA) which will require persons to notify EPA at least 90 days before commencing the manufacture, import, or processing of 2,4-pentanedione (CAS Number 123-54-4) for use in a consumer product. EPA believes that this action is necessary because 2,4-pentanedione may be hazardous to human health and its use in a consumer product may result in significant human exposure. The required notice would provide EPA with the opportunity to evaluate the intended use and associated activities, and an opportunity to protect against potentially adverse exposure to the chemical substance before it can occur.

DATE: Written comments should be submitted to EPA by October 27, 1989.

ADDRESSES: Since some comments may contain confidential business information (CBI), all comments should be sent in triplicate to: TSCA Document Processing Center (TS-780), Office of Toxic Substances, Environmental Protection Agency, Room L-100, 401 M Street SW., Washington, DC 20460.

Comments regarding this proposed SNUR should include the docket control number OPTS-50573. Nonconfidential comments will be placed in the rulemaking record and will be available for public inspection. Unit X of this preamble contains additional information on submitting comments containing CBI.

FOR FURTHER INFORMATION CONTACT: Michael M. Stahl, Director, TSCA Assistance Office (TS-700), Office of Toxic Substances, Environmental Protection Agency, Room EB-44, 401 M Street SW., Washington, DC 20460. Telephone: (202) 554-1404, TDD: (202) 554-0551.

United States
Environmental Protection
Agency

Office of the Inspector General
401 M Street, S.W.
Washington, DC 20460

September 1988



Report of Audit E1G8E9-05-0087-9100485

Capping Report on The
Computation, Negotiation,
Mitigation, and Assessment
of Penalties Under EPA Programs

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UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

SEP 27 1989

OFFICE OF
THE INSPECTOR GENERALMEMORANDUM

Subject: Audit Report No. E1GSE9-05-0087-9100485
Capping Report on the Computation, Negotiation,
Mitigation, and Assessment of Penalties Under EPA
Programs

FROM: Ernest E. Bradley III *Ernest E. Bradley III*
Assistant Inspector General for Audit

TO: Edward E. Reich
Acting Assistant Administrator for Enforcement
and Compliance Monitoring

SCOPE AND OBJECTIVES

We have prepared a "capping" report summarizing previously issued audit reports regarding the computation, negotiation, mitigation, and assessment of penalties under EPA programs. This "capping" report primarily covers the Clean Air Act (CAA), the Clean Water Act (CWA), and the Resource Conservation and Recovery Act (RCRA). The report was prepared to apprise senior EPA management of the recurring problems identified in our individual regional audit reports, and to recommend action or policy changes at the Headquarters level to alleviate similar problems in the future. The objectives of our reviews were to report on:

1. Whether sufficient controls have been established over the computation, negotiation, mitigation, and assessment of penalties in EPA programs.
2. Whether the regions are operating within these established controls.

In developing our findings and recommendations, we used and relied on prior audit results contained in the issued audit reports listed below. Some of these report results are also discussed in this "capping" report. The audit results pertain to (1) violations of media specific programs and (2) the computation, negotiation, mitigation, and assessment of penalties. We used this data in conjunction with our field work to help develop our findings. Appropriate issues contained in the reports are summarized in Exhibit 1.

Office of Mobile Sources' Establishment,
Mitigation, and Collection of Penalties
(E1G16-05-0058-61560), September 1986

Region 5's Stationary Sources of Air Pollution
Compliance and Enforcement Program
(E1K67-05-0449-80743), March 1988

Consolidated Report on EPA's Administration
of the Asbestos National Emission Standard
for Hazardous Air Pollutants (NESHAP)
(E1GM7-05-0571-80821), March 1988

Non-Community Water System Program
(E1HW7-03-0171-81928), September 1988

Region 5's National Pollutant Discharge
Elimination System Permit Enforcement Program
(E1H2D8-05-0293-9100164), January 1989

Report of Region 4's National Pollutant
Discharge Elimination System Permit
Enforcement Program
(E1HWD8-04-0207-9100462), September 1989

Report on National Pollutant Discharge Elimination
System Permit Enforcement Program in Region 2
(E1HWS-02-0133-9100476), September 1989

Report of Region 9's Administration of the
State of Hawaii's Grant Programs for Fiscal
Years 1986 through 1988
(E1F58-09-0184-9100446), August 1989

Consolidated Report on Review of EPA's
Controls Over Administrative Penalties Under
the RCRA Enforcement Program
(E1G68-09-0188-9100479), September 1989

GAO Report--Hazardous Waste...Many
Enforcement Actions Do Not Meet EPA
Standards (GAO/RCED-88-140), June 1988

GAO Report--Inland Oil Spills...Stronger Regulation and
Enforcement Needed to Avoid Future Incidents
(GAO/RCED-89-65), February 1989

The audits listed above and summarized in this report were issued
by our audit office and the U.S. General Accounting Office and
were performed in accordance with the Standards for Audit of
Governmental Organizations, Programs, Activities and Functions

issued by the Comptroller General of the United States. This "capping" report represents a summarization of the findings contained in these reports.

The cases covered in our issued reports were judgmentally selected from various media program universes. We tended to select large dollar amount cases for further evaluation. Thus, statistical projections cannot be made of the remaining cases in the universe. However, while our findings cannot be statistically inferred to the larger universe of all penalty cases, our samples were sufficient to satisfy our audit objectives.

Our review also covered penalty assessment activities for a number of closed cases from the Clean Air and Clean Water programs in Regions 6, 7, and 9. Penalties for these cases were initiated and negotiated during FY 1986 through FY 1988. We did not issue reports on these reviews, but did discuss the details with appropriate regional officials.

We performed the review in accordance with the Government Auditing Standards issued by the Comptroller General of the United States (1988 revision). Fieldwork was conducted from September 24, 1988 through July 13, 1989. We reviewed reports, policies and procedures, regional files, and held discussions with regional and Headquarters enforcement officials to determine the extent of guidance, training, and supervision provided over the negotiation process.

Some of the major internal controls in place relative to the setting and negotiation of civil judicial and administrative penalties under the media programs include:

1. Uniform Civil Penalty Policy (February 1984).
2. Agencywide Compliance and Enforcement Strategy and Strategy Framework for EPA Compliance Programs (May 1984).
3. RCRA Civil Penalty Policy (May 1984)
4. CAA Civil Penalty Policy (September 1984, Revised March 1987)
5. CWA Civil Penalty Policy (February 1986)
6. Quick Look Reports.

Our review did not include an evaluation of the internal controls associated with the input and processing of information into automated records systems, although we did use information contained in these records.

Significant instances of noncompliance with applicable Agency policies and procedures were detailed in the issued reports and some examples are included in this report. No other issues came to our attention which were significant enough to warrant expanding the scope of our review.

The Office of Enforcement and Compliance Monitoring (OECM) and the Office of Policy, Planning, and Evaluation (OPPE) comments and actions taken or planned in response to our findings are discussed in the body of this report. Also, their formal comments dated August 31 and September 1, 1989, to our draft report are attached as appendices to this report. Their actions, if properly implemented, will substantially correct the deficiencies found during our review. We are recommending that the OECM Acting Assistant Administrator ensure that the planned corrective actions are completed.

SUMMARY OF FINDINGS

The Agency needs to take more assertive actions to fully meet the Administrator's goals. These actions include (1) the computation and recovery of economic benefits which violators receive from not complying with EPA's regulations; (2) fully documenting the rationale for reducing calculated penalties; (3) increased reporting and oversight of states' enforcement actions; and (4) inserting penalty results of concluded cases in EPA's Strategic Planning and Management System.

EPA Administrators have continually advocated a position of strong enforcement of EPA regulations. In the 1987 Agency Guidance Document, the Administrator stated: "My goal is to ensure a strong enforcement presence in all our Agency programs. It is extremely important that we maintain a vigorous enforcement and compliance program which is fully integrated into each media program and which addresses localized environmental problems." In 1988 he further stated: "We will enforce environmental laws vigorously, consistently, and equitably to achieve the greatest possible environmental results."

In February 1989 Administrator Reilly set Agency goals to "vigorously" enforce air, water, and waste-disposal laws. Polluters, he stated, "are not going to get away with it" and has pledged to seek stiffer fines. He believes that the heart of the integrity of EPA is vigorous and energetic enforcement. Enforcement, he feels, will help EPA to do the job in the short run that is expected of it by the statutes it administers. Enforcement will also improve the climate for voluntary compliance if people know that EPA means business as enforcers.

1. EPA Needs To Fully Comply With Its Enforcement Penalty Policy

Appropriate penalties were either not calculated and assessed at all, or inadequately calculated. Also, calculated penalties were reduced during negotiations, in some cases in excess of 90 percent and amounting to millions of dollars, with little or no documentation to support the reductions. In many cases the financial benefits the violators received from delayed or avoided costs were not recovered.

Inadequate calculation of penalties and insufficient documentation to support penalty reductions greatly raises the potential for fraud or abuse in EPA's penalty program. Also, GAO's standards for internal control systems, which require that all transactions and events be clearly documented and the documentation available and easily accessible for examination, were not met. In addition, the Agency did not obtain maximum deterrence and fair and equitable treatment of the regulated community in all cases. These violators may have gained an economic and competitive advantage over those who complied with the Agency's regulations.

Generally, the above condition exists because of a lack of attention by Agency personnel to fully complying with the Clean Water Act (CWA), the Resource Conservation and Recovery Act (RCRA), or the Clean Air Act (CAA) civil penalty policies in all cases. For example:

- A prime contractor and subcontractor were cited for failure to (a) provide notification of intent to remove asbestos-containing material, (b) wet asbestos-containing material prior to removal, and (c) store asbestos-containing material in sealed, labeled, leak-tight containers (the material was dumped into an open-bodied truck). However, a penalty was not computed nor assessed for these major violations.
- A region computed an economic benefit of \$342,000 for a CAA violation. This amount was included in the litigation report. Subsequently, the region recomputed the economic benefit as \$12,091 (a 96 percent reduction). The region had no documentation, nor could it satisfactorily explain to us how the \$329,909 (\$342,000 - \$12,091) deduction was determined.

In addition, the U.S. General Accounting Office (GAO) reported in its June 1988 report on "Many Enforcement Actions Do Not Meet EPA Standards" that penalties assessed may not be large enough to offset economic benefits of noncompliance. GAO could not determine whether the three EPA regions covered in its review assessed penalties as prescribed by the RCRA penalty policy because of the lack of documentation in the files. GAO reviewed

31 enforcement cases and found only 2 cases in which it could verify that the economic benefit was calculated in accordance with the penalty policy.

GAO also reported in its February 1989 report on "Inland Oil Spills--Stronger Regulation and Enforcement Needed to Avoid Future Incidents", that overall, fines were rarely used. In fact, seven of the ten regions had never issued penalties even though they had found violations of the regulations.

The Agency, in assessing penalties, had not complied with either the letter or intent of the various penalty policies in all cases. Thus, EPA's goals of deterrence and fair and equitable treatment of the regulated community may not have been fully met. Moreover, allowing a violator to benefit from noncompliance punishes those who have complied by placing them at an economic and competitive disadvantage. This, in effect, creates a powerful disincentive for compliance. The Agency needs to make a stronger commitment to the implementation of the penalty policies in all cases.

In some cases our issued reports covered state activities related to the computation, negotiation, mitigation, and assessment of penalties. To a large degree, we found that states were not properly administering either EPA's or their own penalty policies for the cases we reviewed.

The Acting Assistant Administrator for OEMC substantially agreed with our draft report recommendations that his office and media program Assistant Administrators reemphasize to Agency personnel the need to adhere fully to media program penalty policies. He also agreed to a more aggressive oversight of regional activities. He believes this can best be accomplished through expanding the existing media program oversight audits conducted periodically by each program office with his office's participation.

We are recommending that the Acting Assistant Administrator for OEMC ensure that the planned corrective actions are completed.

2. Penalty Information Needs To Be Part Of EPA'S Strategic Planning And Management System Report

EPA information on civil, judicial, and administrative penalties was not part of the Strategic Planning and Management System Report (SPMS). Nor was penalty information aggregated by the Agency in such a fashion to make it useful in reviewing all of the various issues and concerns associated with the negotiation and assessment of penalties against violators. For example, EPA statistics did not capture the penalties computed and the millions of dollars mitigated by EPA and DOJ negotiators. As a result, senior management cannot adequately judge the success of

the program nor fully identify those areas needing improvement in the computation, negotiation, mitigation, and assessment of penalties.

A measure of the effectiveness of EPA's enforcement program is the percentage of the regulated community in compliance with EPA's regulations. Likewise, a measure of EPA's enforcement effectiveness is the action taken and penalties assessed against those relatively few concerns which do not comply with EPA regulations. It is EPA policy to hit these non-compliers hard with high dollar penalties. The success in bringing them into compliance is an additional benefit of EPA's enforcement policy. EPA's SPMS report does not capture the effectiveness of its enforcement program. Generally, SPMS only shows the status of total cases; nothing is shown regarding penalties.

We recommended in our draft report that OECM implement a SPMS reporting requirement to include the penalty results of concluded cases by media program. SPMS should show computed penalties, reductions by EPA staff, reductions by Department of Justice (DOJ) and EPA attorneys, and the final collected amounts.

The OECM Acting Assistant Administrator believed that requiring the information outlined in our recommendation would result in a significant workload increase. The Assistant Administrator for OPPE would rather use our specific recommendation as part of OECM's management of the Agency's penalty program(s) rather than incorporating such specific details in SPMS.

The information we are asking for, as contained in our recommendation, is already supposed to be produced via the penalty negotiation process; thus, we do not see a major increase in workload.

We are recommending that the OECM Acting Assistant Administrator coordinate with the OPPE Assistant Administrator to assure that Federal penalty results of concluded cases by media programs are accumulated. The data should show computed penalties, reductions by Agency staff, reductions by DOJ and Agency staff, and the final assessed amounts. A decision by appropriate officials can be made at a later date as to whether the data should be made part of SPMS.

ACTION REQUIRED

In accordance with EPA Order 2750, the action official is required to provide this office a written response to the audit report within 90 days of the audit report date.

We have no objection to the further release of this report at your discretion.

BACKGROUND

EPA is responsible for the administration of environmental statutes mandated by Congress. These administrative responsibilities include: the establishment of compliance standards and permits; the monitoring and reporting of compliance; the establishment of strategies for accomplishing compliance; and the actual methods of enforcing compliance.

EPA's enforcement goal is to achieve compliance with environmental laws, regulations and program requirements. One essential element of an enforcement program is the effective use of civil and administrative penalties which punishes the violators and deters future violations. The effectiveness of the enforcement program is measured by the rate of compliance with program goals. The assessment of penalties that are sufficiently burdensome is a critical tool in reaching compliance in a timely manner.

Civil penalties play an important role in an effective enforcement program. Deterrence of noncompliance is achieved through: (1) the perceived likelihood of detecting a violation; (2) the speed of the enforcement response; and (3) the likelihood and severity of the penalty. While penalties are the critical third element in creating deterrence, they can also contribute to greater equity among the regulated community by recovering the economic benefit a violator gains from noncompliance over those who do comply.

The Clean Water Act (CWA)

The Rivers and Harbors Act of 1899 was the first Federal legislation covering water pollution. Fifty-seven years later, Congress enacted the 1956 Federal Water Pollution Control Act (FWPCA), under Public Law (PL) 84-660. FWPCA made Federal grant funds available for the planning, design, and construction of wastewater treatment facilities. The Department of Health, Education and Welfare administered the construction grant program until 1966 when it was transferred to the Department of Interior. The construction grant program was subsequently transferred to the Environmental Protection Agency (EPA) in 1970.

In 1972, the FWPCA was amended and gave way to the CWA, PL 92-500. This resulted in extensive changes to the construction grant program. In addition, the 1972 amendments mandated a strong enforcement program, state and area-wide planning, and the issuance of discharge permits based on approved water quality standards or stringent technology-based effluent limits for all dischargers.

The National Pollution Discharge Elimination System (NPDES) permit establishes the discharge limits which are used to measure compliance with CWA. The CWA required increasingly stringent technology-based effluent limitations for industrial users which are established in the National Effluent Guidelines, 40 CFR 400. For publicly-owned treatment works (POTW), the CWA required secondary treatment limits, or any additional treatment levels necessary to protect water quality, based on effluent limits required to meet the State's Water Quality Standards.

NPDES permits are issued to all point source discharges, which are those POTWs and industrial facilities which discharge directly into navigable waters. Facilities are classified as either major or minor depending on the volume or effluent discharged. Permits require monitoring by the permittee to verify compliance with the effluent limits. A Discharge Monitoring Report (DMR) is usually submitted monthly by the permittee to the administering agency. The DMR is reviewed to determine the permittee's compliance or noncompliance with the permit. Title 40 CFR 123.45 requires administering agencies to report the compliance status of facilities with NPDES permits in Quarterly Noncompliance Reports. The regulations provide criteria for the types of violations that are to be reported in the Reports. Also, any violation or instance of noncompliance is subject to enforcement action.

The CWA includes administrative, civil, and criminal enforcement remedies for noncompliance. EPA can sue civilly in court for \$25,000 per day per violation, as well as injunctive relief under Section 309(d) of the Act, or seek criminal penalties under Section 309(c). Administratively, EPA can issue an administrative compliance order to the violator under Section 309(a) of the Act. The 1987 amendments to the CWA gave EPA the ability to assess penalties administratively. Under Section 309(g) of the Act, the EPA Administrator can impose civil penalties of up to \$125,000 for noncompliance with program requirements.

The Resource Conservation and Recovery Act (RCRA)

RCRA was passed as Public Law 94-580, an amendment to the Solid Waste Disposal Act, on October 21, 1976. Congress' overriding purpose in enacting RCRA was to establish the statutory framework for a national system that would ensure the proper management of hazardous waste. Regulation of these materials was intended to prevent future hazardous waste problems and reduce threats to the public health and the environment. RCRA was amended in 1980 and 1984 increasing EPA's enforcement authorities and substantially increasing the implementing requirements for the regulated community. Section 3008 of RCRA gives the EPA Administrator the

authority to assess civil penalties of up to \$25,000 per day per violation for noncompliance with program requirements or with an order.

The Clean Air Act (CAA)

Since the mid-1950's, the nation has maintained a commitment to protecting the environment and public health from the adverse effects of air pollution. This commitment is important because air pollution, brought about by urbanization, industrial development, and the increasing use of motor vehicles, has resulted in mounting dangers to the public health and welfare.

Direct sources of air pollution are generally categorized as either stationary or mobile. Stationary sources include factories, power plants, and smelters, while mobile sources include automobiles, buses, and trucks. Some facilities, like highways and shopping centers, are called indirect sources because they attract mobile sources of pollution. This report only focuses on cases dealing with stationary sources of pollution and the related assessed fines.

Congress enacted the CAA in 1963, under PL 88-206, as the basic statute governing the nation's effort to protect the public health and welfare from the harmful effects of air pollution. The CAA was substantially amended in 1970 and 1977. The CAA requires both EPA and state and local governments to assume responsibility for the implementation of measures for prevention and control of air pollution at its source. EPA establishes air quality standards, conducts research, and provides technical and financial assistance to state and local governments. States are responsible for developing plans describing how they will control pollutant emissions from stationary sources in order to meet and maintain air quality standards.

The CAA includes administrative, civil, and criminal enforcement remedies to correct instances of noncompliance. EPA can administratively issue a notice of violation and assess a civil penalty. Civil relief may take the form of an injunction requiring compliance with applicable regulations. Significant monetary penalties may also be assessed with civil relief measures. Section 113(b) of the Act authorizes the EPA Administrator to assess penalties of up to \$25,000 per day per violation for noncompliance with program requirements.

Civil Penalty Policy

In February 1984, EPA issued the Uniform Civil Penalty Policy. It established a consistent agency-wide approach to the assessment of civil penalties. This policy established a single

set of goals for penalty assessment in administrative and judicial enforcement actions. These goals, which are incorporated in current program specific policies, are:

- deterrence;
- fair and equitable treatment of the regulated community; and
- swift resolution of environmental problems.

The first and primary goal of penalty assessment is deterrence. A penalty should provide specific deterrence by persuading a violator to take all necessary precautions against falling into noncompliance a second time; and it should engender general deterrence among the regulated community, i.e., dissuading others from violating the law.

The second goal is fair and equitable treatment of the regulated community. This requires that penalties be consistent and flexible. Consistent because otherwise penalties will be seen as arbitrary and violators will vigorously defend themselves and tie-up scarce EPA resources, and flexible so that adjustments to reflect legitimate differences between similar violations can be made.

The third goal is the swift resolution of environmental problems. The primary mission of EPA is to protect the environment including the public health.

The establishment of an agency-wide general penalty policy eventually led to the issuance of program specific penalty policies. In May 1984, the Office of Solid Waste issued the RCRA Civil Penalty Policy. In September 1984, the Office of Air and Radiation issued its initial CAA Civil Penalty Policy, which was revised in March 1987. The Office of Water, which issued a general principles policy in 1980, formulated its program specific CWA Civil Penalty Policy in February 1986.

The above documents set forth the Agency's policy for assessing penalties under their respective programs. The purpose of the policies is to assure that: (1) persons are deterred from committing violations; (2) penalties are appropriate for the gravity of the violations committed; (3) economic incentives for noncompliance are eliminated; (4) penalties are assessed in a fair and consistent manner; and (5) compliance is achieved. This system of penalty assessment adheres to the Agency policy by requiring: (1) calculation of a preliminary deterrence amount consisting of a gravity component; (2) determination of the economic benefits of noncompliance; and (3) application of adjustment factors within specified boundaries to account for differences between cases.

FINDINGS AND RECOMMENDATIONSFINDING NO. 1- EPA NEEDS TO FULLY COMPLY WITH ITS ENFORCEMENT PENALTY POLICY

Appropriate penalties were either not calculated and assessed at all, or inadequately calculated. Also, calculated penalties were reduced during negotiations, in some cases in excess of 90 percent and amounting to millions of dollars, with little or no documentation to support the reductions. In many cases the financial benefits the violators received from delayed or avoided costs were not recovered.

Inadequate calculation of penalties and insufficient documentation to support penalty reductions greatly raises the potential for fraud or abuse in EPA's penalty program. Also, GAO's standards for internal controls systems, which require that all transactions and events be clearly documented and the documentation available and easily accessible for examination, were not met. In addition, the Agency did not obtain maximum deterrence and fair and equitable treatment of the regulated community in all cases. These violators gained an economic and competitive advantage over those who complied with the Agency's regulations.

Generally, the above condition exists because of a lack of attention by Agency personnel to fully complying with the Clean Water Act (CWA), the Resource Conservation and Recovery Act (RCRA), or the Clean Air Act (CAA) civil penalty policies in all cases. For example:

- A prime contractor and subcontractor were cited for failure to (1) provide notification of intent to remove asbestos-containing material, (2) wet asbestos-containing material prior to removal, and (3) store asbestos-containing material in sealed, labeled, leak-tight containers (the material was dumped into an open-bodied truck). However, a penalty was not computed nor assessed for these major violations. (EPA Audit Report No. E1GM7-05-0571-80821)
- While reducing the proposed penalty of \$500,000 down to \$75,000 (an 85 percent reduction), the region did not document its basis for the reduction. In fact, the region requested and received an Administrative Law Judge (ALJ) ruling that held the company liable for the complaint facts supporting the proposed penalty. However, our discussions with regional program personnel indicated that they did not expect to pursue the full proposed penalty during settlement negotiations. In part, they were concerned that, even with the ruling, the ALJ would not support the region's desired penalty and would only allow a penalty of \$10,000. The

region's desired or target penalty was established at \$100,000, or 20 percent of the proposed penalty. The basis for the desired penalty was not documented in the region's records. We found no evidence to substantiate the region's concern about the ALJ not supporting them in adjudicating the case.

We noted that the region's proposed penalty of \$500,000 was a reduction from its first penalty calculation of \$6,885,000. The first penalty calculation considered 306 days of violations. The region's justification for the reduction to \$500,000 was "to account for any efforts made by the company and to reflect the civil penalty policy concerns with deterrence and fair and equitable treatment of the regulated community". We found little evidence of self-initiated efforts by the company to substantiate this significant pre-complaint reduction.

The final penalty of \$75,000 represented only 1 percent of the original pre-complaint calculated penalty and only 15 percent of the proposed penalty. (EPA Audit Report No. E1G68-09-0188-9100479)

A region computed an economic benefit of \$342,000 for a CAA violation. This amount was included in the litigation report. Subsequently, the region recomputed the economic benefit as \$12,091 (a 96 percent reduction). The region had no documentation, nor could it satisfactorily explain to us how the \$329,909 (\$342,000 - \$12,091) deduction was determined. (EPA Audit Report No. E1K67-05-0449-80743)

In addition, the U.S. General Accounting Office (GAO) reported in its June 1988 report on "Many Enforcement Actions Do Not Meet EPA Standards" that penalties assessed may not be large enough to offset economic benefits of noncompliance. GAO could not determine whether the three EPA regions covered in its review assessed penalties as prescribed by the RCRA penalty policy because of the lack of documentation in the files. GAO reviewed 31 enforcement cases and found only 2 cases in which it could verify that the economic benefit was calculated in accordance with the penalty policy.

GAO also reported in its February 1989 report on "Inland Oil Spills--Stronger Regulation and Enforcement Needed to Avoid Future Incidents," that overall, fines were rarely used. In fact, seven of the ten regions had never issued penalties even though they had found violations of the regulations.

The Agency, in assessing penalties, had not complied with either the letter or intent of the various penalty policies in all cases. Thus, EPA's goals of deterrence and fair and equitable treatment of the regulated community were not fully met.

Moreover, allowing a violator to benefit from noncompliance punishes those who have complied by placing them at an economic and competitive disadvantage. This, in effect, creates a powerful disincentive for compliance. The Agency needs to make a stronger commitment to the implementation of the penalty policies in all cases.

In some cases our issued reports covered state activities related to the computation, negotiation, mitigation, and assessment of penalties. To a large degree, we found that states were not properly administering either EPA's or their own penalty policies for the cases we reviewed.

Penalties Need To Be Calculated

EPA's General Enforcement Policy, dated February 1984, establishes a single set of goals for penalty assessment in administrative and judicial enforcement actions:

- deterrence;
- fair and equitable treatment of the regulated community; and
- swift resolution of environmental problems.

The most important mechanisms for achieving consistency are the systematic methods for calculating the economic benefit component (i.e., the financial benefit the violator received from delayed or avoided costs) and the gravity component (which reflects the actual or potential harm to the environment, importance of the regulatory scheme, and the size of the violator) of the penalty. If the Agency is to promote consistency, it is essential that penalties be calculated and each case file contain a complete description of how each penalty was developed.

The following examples taken from our issued reports and our field work show a lack of computation of a penalty amount and assessment of a penalty, or an insufficient penalty calculation for major violations of EPA regulations.

- A region issued a Finding of Violation to a contractor citing failure to provide notice of renovation operations, including asbestos material, and removal of friable asbestos material in a manner that broke up the friable asbestos material. This finding resulted from an EPA inspector's observation of the renovation process. His inspection report stated, "Ceiling of most rooms pulled down to expose

HVAC ducting. Asbestos laden materials in piles on floor. High dust levels. Workmen left door open for ventilation while they were working. No respiratory protection used."

In this instance not only the workers, but the general public was exposed to asbestos fibers. The region's enforcement action was limited to an Administrative Order requiring the contractor to comply with asbestos NESHAP regulations in the future. Based on the guidance in the Asbestos Demolition and Renovation Civil Penalty Policy, a penalty of \$37,000 would have been appropriate. (EPA Audit Report No. ElGM7-05-0571-80821)

There was no documentation in the region's files that it had estimated the economic benefits of noncompliance in three of the four cases we reviewed. For example, the region filed a complaint against a company which included 18 RCRA violations. The complaint included a variety of RCRA violations including: ignitable waste operating practice violations, failure to prepare and submit various plans and records, no financial assurance for closure or accidental occurrences, and no groundwater monitoring. We found no evidence that the region had calculated the estimated economic benefits. For the types of violations cited in the complaint, it is reasonable to expect that the company substantially benefited from avoiding the costs of compliance with the groundwater monitoring and financial assurance requirements. (EPA Draft Audit Report No. ElG68-09-0188)

In addition, GAO reported in its June 1988 report on "Hazardous Waste...Many Enforcement Actions Do Not Meet EPA Standards" that penalties assessed may not be large enough to offset the economic benefits of noncompliance. GAO could not determine whether the three EPA regions covered in its review assessed penalties as prescribed by the RCRA penalty policy because of the lack of documentation in the files. GAO reviewed 31 enforcement cases and found only 2 cases in which it could verify that the economic benefit was calculated in accordance with the penalty policy. For the remaining 29 cases GAO found:

- The economic benefit was not shown in the penalty calculation of 15 cases.
- Documentation was not available on the penalty calculation for 5 cases.
- The economic benefit calculation was not considered necessary by the GAO reviewers in 9 cases.

The EPA Office of Waste Programs Enforcement responded to GAO's finding. Among the corrective actions planned was:

- Reemphasis of the importance of adequate documentation of penalty calculation.
- The development of a manual that includes computer tracking and regular supervisory review of active cases.
- Training on developing administrative records.
- Focus on the quality of case files during bi-annual reviews of regions, including penalty calculations.

In addition, GAO issued a report, "Inland Oil Spills--Stronger Regulation and Enforcement Needed to Avoid Future Incidents" in February 1989. The CWA authorizes fines of up to \$5,000 per day for each violation of EPA's Oil Pollution Prevention regulations. GAO reported that there is no national guidance on the imposition of fines and the regional offices have adopted inconsistent policies. GAO further reported that overall, fines were rarely used, although EPA's data indicate that the rate of noncompliance with the regulations may be high. In fact, seven of the ten EPA regions had never issued penalties even though they had found violations of the regulations. Among the GAO recommendations was that EPA establish a policy for fining violators.

Need To Fully Justify Reduction To Penalty Calculations

A major objective of the various penalty policies is to negate the "economic incentives for noncompliance". This is accomplished by calculating a component for the economic benefits of noncompliance, and adding to it a gravity-based penalty component. Thus, it shields the economic benefits component from any mitigating adjustments during negotiations of the final penalty. If a penalty is to achieve deterrence, both the violator and the general public must be convinced that the penalty negates the violator's enhanced position relative to those who have complied in a timely fashion.

The various media penalty policies require that when the assessed penalty fails to remove the economic benefit, the case development team must explain in the case file why it failed to do so. The policies also provide that documentation for deviations from the program-specific guidance should be contained in both the case file and in any memoranda that accompanies the settlement. This point was reiterated in a joint Region 5 memorandum issued by the Regional Counsel and the Director of the Water Division to the Air, Water, Toxic, and General Law Branch staff and the Water Division Technical Enforcement staff, on "Revisions of Bottom Line Penalties in Water Cases". The

memorandum stated that, when a consensus was reached on revisions to a penalty amount, the rationale for the decision should be covered in a memorandum to the Assistant Administrators for OEOM and Water. The clear intention of these policies is to make the negation of the violator's economic benefits the primary focus of the penalty process.

The various penalty policies provide guidelines within which enforcement personnel may mitigate penalties. The adjustments usually apply to the gravity-based penalty component and not to the economic benefit component. The intent of this limitation is to shelter at least for most typical cases, the economic benefit component from the negotiations to ensure that the violator gains no competitive advantages from the noncompliance. The various program specific policies include the acceptable justifications for mitigating penalties as: (1) good faith efforts to comply; (2) degree of willfulness or negligence; (3) history of noncompliance; (4) financial ability to pay; and (5) other unique factors.

Each media penalty policy has its own parameters for adjustments to the gravity-based component. For the CWA program there are three suggested ranges of adjustment:

- 0 to 20%: within the absolute discretion of the litigation team;
- 20 to 30%: only appropriate in unusual circumstances; and
- 30% plus: only appropriate in rare circumstances.

The two suggested ranges of adjustments for the RCRA program are:

- 0 to 25%: within the absolute discretion of the litigation team; and
- 26 to 40%: only appropriate in unusual circumstances.

For the CAA program the three suggested ranges of adjustment are:

- 0 to 30%: within the absolute discretion of the litigation team;
- 31 to 50%: only appropriate in unusual circumstances;
- 50% plus: only appropriate in rare circumstances.

The mitigation or adjustment of penalties must be documented and is appropriate only to the extent that the violator clearly demonstrates an entitlement to the adjustment. The burden of proof rests squarely upon the violator. Without such proof the

various penalty policies prohibit enforcement personnel from making any mitigating adjustments to the calculated penalty amount. The Clean Water Act policy, however, allows use of "litigation considerations" that are not limited and do not put the burden of proof on the violator.

The following examples taken from our issued reports show a lack of documentation for significantly reducing computed penalties. Additional examples are in Exhibit 2.

Clean Water Act Case (EPA Audit Report No. E1HWDS-04-0207-9100462)

- The city was one of the region's worst violators. The region computed a penalty of \$3,684,360 consisting of a \$614,060 recalcitrance figure, an economic benefit figure of \$574,300, and a gravity-based component of \$2,496,000. Citing litigation considerations of \$2,947,488 and ability to pay considerations of \$700,028, the region computed a settlement amount of \$36,844. There was no support to show the method used to arrive at the litigation consideration figure (\$2,947,488). It seemed to be an arbitrarily arrived at figure designed to reduce the amount recommended for the penalty. The case remained unresolved at the close of our audit work and the facility remained in non-compliance.

Resource Conservation and Recovery Act Case (EPA Audit Report No. E1G68-09-0188-9100479)

- The negotiators reduced the proposed penalties of \$2,488,775 down to \$90,000 or a reduction of 96 percent. The proposed penalties included \$2,425,000 (\$25,000 per day for 97 days) for operating a hazardous waste surface impoundment without a permit or interim status, and \$63,775 for several other counts including inadequate liability coverage and illegal international shipments of hazardous waste.

Regional negotiators offered to reduce the penalty from \$25,000 per day to \$9,500 per day based on a reassessment of the potential harm. No documentary evidence to support this reassessment could be found in the region's records.

As negotiations proceeded, the region set a target penalty settlement of \$200,000. The basis for the settlement target was not clearly documented in the region's records. The region settled on a final assessed penalty of \$90,000 to be paid in installments over three years. Justification for settling on \$90,000 over three years was not documented in the region's case files.

Clean Air Act Case (EPA Audit Report No. ELK67-05-0449-80743)

A company accrued economic benefits of \$900,000 over a two and one-half year period of violations, but the region reduced the amount to \$14,000 because the company exceeded its emission standard for only 15 days during this time. Even though there were only 15 days of violation, the company saved \$900,000 by delaying the installation of the pollution control equipment.

The region stated that the company did not continuously violate the CAA and the civil penalty policy assumes continuous violation of the statute is necessary. We believe it is of little consequence that the violations were on occasions or on a continuous basis, the economic benefit from delayed investment in pollution control equipment is the same. EPA's policy is to recover the savings the violator received from delayed and avoided costs. The CAA authorizes EPA to assess penalties of up to \$25,000 per day per violation for noncompliance with program requirements; in this case \$375,000 (15 days times \$25,000 per day). There should have been a higher collection to offset the economic benefits in this case.

Most Agency personnel agreed that there were lapses in documenting the penalty calculations and subsequent penalty adjustments. Some regions, to correct this situation, issued instructions for the computation and documentation of all penalties in the future.

We noted that in March 1986, the OECM Associate Enforcement Counsel, Air Enforcement Division, informed all Regional Counsels of the need to document settlements of penalty cases. The memorandum instituted the requirements that: (1) all new air enforcement litigation reports contain the calculations which support the penalty recommended as the minimum settlement penalty, and (2) regional case files contain documentation of the rationale for changes in the penalty from the time a case is referred until a consent decree is signed.

Further, the memorandum provided that:

After an enforcement action has been referred, regional case attorneys should record in their case files any change in the settlement penalty based on negotiations with the source or new information related to the merits or the equities of the case which came to light after the litigation report was written. The record should reflect the date and Headquarters person who approved the change, as required by policies GM-26 and GM-39 in the General Enforcement Policy

Compendium. This procedure carries forward, after the referral date, EPA's ability to show that penalties are determined in a logical and rational manner.

Other Media Programs

Although we did not perform detail work in other media programs, our analysis of the files supporting OECM's claimed \$24 million assessed penalties in FY 1987 showed significant reductions to recommended penalties in the Toxic Substance Control Act (TSCA) and the Federal Insecticide, Fungicide, and Rodenticide Act (FIFRA) programs. We computed, by program area for TSCA and FIFRA, the following reductions from the regions' recommended penalties.

<u>Program Area</u>	<u>No. of Cases Reviewed</u>	<u>Recommended Penalties</u>	<u>Assessed Penalties</u>	<u>Percent of Recommended Penalties Reduced</u>
<u>All FY 1987 Closed Cases</u>				
TSCA	741	\$27,571,485	\$5,057,829	82
FIFRA	198	1,093,458	248,539	77

In reply to our draft report, the Acting Assistant Administrator for OECM stated that within the relatively short time to review this issue, OECM has evaluated these statistics with the Office of Pesticides and Toxic Substances' Office of Compliance Monitoring and has reached the following conclusions.

TSCA

A large percentage (over 50%) of the 741 cases settled during FY 1987 involved violations of the Asbestos In Schools regulations, 40 CFR 763 et seq. Because the regulated community consists entirely of public and private educational institutions, the Agency penalty policy recommended that the penalties be substantially mitigated or even fully abated if the school undertook asbestos abatement actions, which were not required under TSCA or the Part 763 rules.

Also, TSCA penalties must be reduced by statute, whenever they may substantially affect a facility's "ability to continue in business" or if there is a financial condition which prevents its ability to pay the fine from cash reserves. Before EPA will consider reducing a penalty based upon ability to pay, EPA enforcement offices are instructed

to obtain credible financial information, such as tax returns, corporate balance sheets or other similar financial documentation.

Finally, TSCA penalties have been reduced in settlement to obtain leverage for environmentally beneficial expenditures as a condition of settlement. Generally, "settlements with conditions" involve the implementation of compliance or abatement activities which are unrelated to correcting the violation that is the subject of the enforcement action (that is a cost that can not be used to reduce the penalty) or implementation of a compliance audit. An example of a penalty mitigation project might involve the accelerated removal and disposal of PCB electrical equipment. A dollar for dollar credit is not given. Some offices have given a \$1.00 reduction for each \$3.00 spent up to a maximum penalty reduction. With the increased emphasis in EPA on "pollution prevention", it is anticipated that a greater number of cases may be settled with conditions like these and care must be taken to insure that adequate documentation is maintained in the official file and that certification of completion is submitted and verified to ensure that settlement terms are met.

To insure that penalty reductions are appropriately documented, the TSCA Civil Penalty Policy, published at 45 F.R. 24358 September 10, 1980, requires that the published work sheet be completed to document each penalty reduction.

FIFRA

In the FIFRA program, a civil penalty matrix and categories of violations were published in the Federal Register in 1974. This guidance provides that the civil penalty to be imposed must take into account the size of the violator's business. EPA must then impose a graduated penalty based upon 5 category sizes of business, the largest category being over \$1,000,000 in gross sales. EPA regional offices endeavor to place the violator into the appropriate category through reliance on the most readily accessible data, which are Dun and Bradstreet financial reports. Often, however, at settlement conferences, FIFRA violators are able to demonstrate through actual tax returns or accounting statements that the Dun and Bradstreet reports, which are advisory and not based on actual certified tax returns are inflated. Under FIFRA, by statute, EPA is precluded from asking for tax returns or financial or sales data at the time of inspection.

FIFRA penalties may also be reduced for factors similar to TSCA (settlements with conditions or abatement activity), although to a much lesser degree. Finally, a significant

factor in many FIFRA reduction concerns that type of violation actually involved. The more hazardous misuse of pesticides violation, by statute, are to be handled by the state lead agencies. This leaves Federal enforcement efforts to concentrate on violations of misbranding (i.e., false labels or false claims) or failure to submit annual production reports under FIFRA. In a large proportion of these cases, perhaps 35 percent are marginal businesses or businesses which are about to, or have, ceased operations. In these cases, very minor fines may be collected along with terminations or surrender to the Registrant's FIFRA establishment number.

State Penalty Practices

Some of our issued reports covered state activities related to the computation, negotiation, mitigation, and assessment of penalties. To a large degree, we found that states were not properly administering either EPA's or their own penalty policies for the cases we reviewed. It should be noted, however, that EPA policy does not require states to follow EPA's penalty policy.

Clean Water Act

1. From our judgmental sample of 10 cases in which a penalty should have been assessed, we found that a state calculated and assessed penalties in only two cases. We arbitrarily selected 10 other cases in which penalties were assessed which gave us a total of 12 cases (10 + 2) in which penalties were calculated and assessed. Penalties were not calculated in accordance with the state guidelines in 9 of the 12 cases. In the remaining three cases the economic benefit was recovered only in one case.

From our judgmental sample of 10 cases, we found another state had calculated and assessed penalties in only 6 cases. There was no calculation of penalties in the remaining four cases. The computed economic benefit of \$637,775 for the 6 cases was mitigated to \$88,000, a reduction of \$549,775, or 86 percent.

The region having oversight responsibility over these two states told us that it has instituted a tracking and quarterly reporting system for state penalties. This will enable the region to ensure that the states are collecting sufficient penalties. Additional documentation of how penalties are calculated will also be requested from the states to show that assessed penalties comply with national and state policies. (EPA Audit Report No. E1H2D8-05-0293-9100164)

2. The company experienced at least three illegal discharges in violation of its NPDES permit conditions in 1986 and 1987. No monetary penalties were proposed for any of the violations although the permit provides for civil penalties not to exceed \$10,000 (prior to February 1987) and \$25,000 (after February 1987) for each violation.

As a result of the first of the three discharges, the state issued a Notice of Violation (NOV) to the company on December 2, 1986 for the discharge of 13,500 gallons of process water. The second discharge, involving 4 million gallons of mill sludge occurred on February 27, 1987, and was due to the failure of the facility's main holding pond embankment. The state issued another NOV to the company on April 8, 1987. The state inspection report relating to the discharge stated: "The discharge was a major event which had a severe impact on the area surrounding the discharge point."

The third discharge occurred on March 31, 1987 and involved 400,000 gallons of process wastewater. As a result of this discharge, the state issued a letter of minor violation to the company on April 8, 1987. This letter was issued on the same date that the NOV was issued for the second discharge. We believe that serious questions are raised about the state's enforcement policies when it issues a NOV and a letter of minor violation on the same date to the same violator and neither action includes a monetary penalty. It is also difficult to understand how the state can rationalize that the two discharges were not indicative of serious violations of permit conditions; especially since the facility had three discharge violations in a 4-month period. (EPA Audit Report No. E1F58-09-0184-9100446)

Safe Drinking Water Act (EPA Audit Report No. E1HW7-03-0171-81928)

- The four states covered by our review did not (1) issue timely violation notices to the suppliers, (2) obtain evidence of public notification, (3) perform any significant enforcement actions against non-community water systems (NCWS), (4) develop or implement enforcement strategies against NCWS, and (5) comply with Federal reporting requirements concerning enforcement actions. Some states were not able to provide statistics for the number of enforcement actions regarding NCWS. We were informed by various personnel that enforcement resources were limited at best and were generally directed at community water systems.

Clean Air Act - NESHAP (EPA Audit Report No. E1GM7-05-0571-80821)

The delegated agencies in a state did not commit themselves to EPA's civil penalty policy, differed among themselves as to the severity of cash penalties, and resolved major violations without assessing cash penalties. One agency based their initial penalty calculation on the EPA civil penalty policy, but the amount was automatically reduced 90 percent prior to making a settlement proposal to the violator. In addition, if the violator was cooperative and agreed to take corrective action, the penalty assessment was frequently reduced or waived during the settlement process.

Also, penalties were not always assessed. For example:

1. A prime contractor and subcontractor were cited for the following violations during the renovation of a building.

- Failure to provide notification of intent to remove asbestos-containing material.
- Failure to wet asbestos-containing material prior to removal.
- Failure to store asbestos-containing material in sealed, labeled, leak-tight containers (the material was dumped into an open-bodied truck).

Even though the violators did not follow asbestos NESHAP regulations and gained significant economic benefits and posed potentially serious health hazards to the public, a penalty was not computed nor assessed for these major violations.

2. An asbestos abatement company was cited for the following violations during the renovation of an elementary school.

- Failure to wet asbestos-containing material prior to removal.
- Storage of dry asbestos material in unsealed bags. Even though the violator did not follow asbestos NESHAP regulations and gained significant economic benefits and posed potentially serious health hazards to the public, a penalty was not computed nor assessed for these major violations.

State agencies were not aggressively enforcing the asbestos NESHAP regulations with penalties. Low or no penalties could lead to repeat violations.

Clean Air Act--Stationary Sources (EPA Audit Report No. E1F58-09-0184-9100446)

The company was consistently in violation of the visible emissions air standard for opacity since at least 1980. Although the company was fined \$500 in 1980 for its air standards violations, it was not placed on a compliance schedule at the time. As a result, violations continued. A state inspection report issued in October 1985 noted that the company was in continuous violation of the opacity limit. However, no penalty was assessed as a result of the inspection.

In April 1986, a compliance schedule was agreed to by the state and the company. The schedule required the company to construct a scrubber to control visible emissions from the bypass burner boiler by July 1988. In June 1987, the state revised the compliance schedule and extended the scrubber installation date to July 1989. In May 1988, the state again revised the schedule and this time extended the scrubber installation date to July 1990. Thus, during the 10-year period 1980 and 1990, the company will have continuously violated air standards and paid a total penalty of only \$500. It is apparent such a nominal penalty does not meet EPA's enforcement policies. More importantly, the state enforcement policies have almost no impact on eliminating this source of air pollution.

Need for Continuing Education Regarding Negotiation Skills

OECM has offered "Negotiation Skills Training" courses to regional attorneys. This 2-day course was provided six times during FY 1988 and seven times in FY 1989, but not to all attorneys. The course covers a variety of areas including:

- Basic concepts as applied to environmental enforcement negotiations.
- Planning for negotiations.
- Pressure points.
- Defensive tactics.

We reviewed the training courses taken by attorneys in Regions 5, 6, 7 and 9 who were involved in negotiations of penalties. Of the 12 attorneys we interviewed, 5 did not have the "Negotiation Skills Training".

In December 1988, a National FY 1988 Regional Counsel Audit Report was issued by OECM and General Counsel. The report is a compilation of individual audits and a separate report was issued to each Regional Counsel. The report's primary finding regarding resource issues was the high turnover of professional and support staff. The turnover rate was very serious in some regions. For example, over the past 2 years Region 1 has experienced close to a 50 percent turnover and Region 3 a 40 percent turnover.

Negotiation of penalties is a very important aspect of an attorney's duties. It is an area covered in each attorney's performance standards. Because of the high turnover of attorneys in some regions, OECM should strongly consider providing the training to all appropriate Regional Counsel staff. The training should be a requirement for attorneys assigned penalty negotiation cases. Such training is essential if the regions are going to enforce environmental laws vigorously, consistently and equitably.

* * * * *

Penalties play an important role in an effective enforcement program. Deterrence is achieved to a major degree by the likelihood and severity of a penalty. The regulated community has had ample time to become aware of EPA's rules and to implement internal controls to ensure compliance. Now is the time for the Agency to strengthen its enforcement actions against those violators and impose penalties large enough to punish them and bring about compliance.

In addition, it is essential that the best results are obtained by EPA from each violator of Federal statutes. Otherwise the violator will use settlements on prior cases as a negotiation factor during litigation. For example, during the litigation of one case, we found references to a previously settled case concerning another violator. The defendant stated that it attempted to analyze and compare its situation with that of another company with a similar situation. Their analysis disclosed that the volume of effluent from the other company's three very large plants was about twice the volume of its relatively small eight plants and the approximate severity of the violation of metals standards in the other company's effluent was about four times its own. Yet, the penalty proposed to them is about two and two-thirds times the penalty assessed the other company. Along these lines, we were informed by a regional staff attorney that legal counsel for violators contact one another to exchange insights and legal strategies for their clients defense against EPA civil actions.

In reviewing the effectiveness of a program in accomplishing its goals and objectives, it is important to evaluate it in light of the program's internal controls. Internal control standards

define the minimum level of quality acceptable for internal control systems, and constitute the basis against which systems are to be evaluated. The GAO general and specific standards that apply to EPA programs include the following:

- Internal control systems, all transactions and events are to be clearly documented, and the documentation available and easily accessible for examination.
- Transactions and other significant events are to be promptly recorded and classified.
- Transactions and other significant events are to be authorized and executed only by persons acting within the scope of their authority.
- Competent personnel, adequately trained and assessed on their implementation of necessary internal controls.

Regarding the first three standards, our reviews showed a need for Agency personnel to fully document the transactions and events pertaining to the computation, negotiation, mitigation, and assessment of penalties. There is also a need for "Negotiation Skill Training" for all attorneys engaged in enforcement negotiations.

Draft Report Recommendations

We recommended that the OECM Acting Assistant Administrator in coordination with the Office of General Counsel and the Assistant Administrators for the program Offices of (1) Air and Radiation, (2) Solid Waste and Emergency Response, (3) Water, and (4) Pesticides and Toxic Substances:

1. Re-emphasize to Agency personnel the need to fully adhere to media program penalty policies.
2. Institute a more aggressive oversight program of regional activities. Such a program would include expanded reviews of regional penalty programs to include adequacy of penalty computations, Agency reductions to the computed amounts, negotiations of further reductions by Department of Justice and Agency attorneys during negotiations with violators, and the adequacy of documentation to support the decisions.

The regional oversight of state activities should be part of the Headquarters expanded reviews. These reviews would also ensure that the various regional offices have established procedures in place that implement the media programs' civil penalty policy.

3. Institute a regional reporting and oversight program of state penalty assessment activities to ensure that proper penalties are levied.
4. Coordinate with the Office of General Counsel and provide "Negotiation Skills Training" to appropriate Regional Counsel staff on a regular and timely basis. Consideration should be given to making this training mandatory for all attorneys engaged in enforcement negotiations.

Agency Reply To OIG Draft Report

The Acting Assistant Administrator for OECM agreed with our recommendations. Regarding more aggressive oversight of regional activities, he believes this can best be accomplished through expanding the existing media program oversight audits conducted periodically by each program office with his office's participation.

With respect to "Negotiation Skills Training", OECM will review the implications of making this training, or its equivalent, mandatory for those attorneys engaged in enforcement negotiations.

Recommendation

We recommend that the Acting Assistant Administrator for OECM ensure that the planned actions are completed.

FINDING NO. 2- PENALTY INFORMATION NEEDS TO BE PART OF EPA'S
STRATEGIC PLANNING AND MANAGEMENT SYSTEM REPORT

EPA information on civil, judicial, and administrative penalties was not part of the Strategic Planning and Management System Report (SPMS). Nor was penalty information aggregated by the Agency in such a fashion to make it useful in reviewing all of the various issues and concerns associated with the negotiation and assessment of penalties against violators. For example, EPA statistics did not capture the penalties computed and the millions of dollars mitigated by EPA and DOJ negotiators. As a result, senior management cannot adequately judge the success of the program nor fully identify those areas needing improvement in the computation, negotiation, mitigation, and assessment of penalties.

A measure of the effectiveness of EPA's enforcement program is the percentage of the regulated community in compliance with EPA's regulations. Likewise, a measure of EPA's enforcement effectiveness is the action taken and penalties assessed against those relatively few concerns which do not comply with EPA regulations. It is EPA policy to hit these non-compliers hard with high dollar penalties. The success in bringing them into compliance is an additional benefit of EPA's enforcement policy. EPA's SPMS report does not capture the effectiveness of its enforcement program. Generally, SPMS only shows the status of total cases; nothing is shown regarding penalties.

The Quick Look Report -- Consolidated Docket Enforcement System - which OECM and the media program staff rely upon to monitor the status of civil cases could be used to accumulate the appropriate penalty information for the SPMS report. Data for each case include the dollar amount for the computed economic benefit, the gravity component, proposed penalty, and assessed penalty. However, it is not uncommon for the economic benefit and gravity component amounts to be missing. This area is discussed below.

OECM's Quick Look Report Not Complete

Both the EPA Uniform Civil Penalty Policy of February 1984, and the various program specific penalty policies (CAA, CWA and RCRA), mandate the inclusion of the economic benefits of noncompliance gained by a violator in the calculation of the proposed and assessed penalties. The various policies require that an "economic benefit component" be calculated and added to the gravity-based penalty component when a violation results in (significant) economic benefit to the violator. RCRA policy defines a significant economic benefit, in monetary terms, as one that exceeds \$2,500; while the CAA policy defines it as one that exceeds \$5,000.

We obtained a report, as of October 1988, that the Agency uses in managing its penalty universe (Quick Look Report--Consolidated Enforcement System). We found that the management information was significantly lacking in data on the computation of economic gains and gravity amounts (See Exhibits 3, 4, and 5 for examples of CWA, RCRA, and CAA print outs, respectively).

Our analysis of the report information showed the following:

Program	No. Of Cases	No. Of Cases		Percent	
		Penalty Not Shown	Benefit Gravity	Benefit	Gravity
CWA	274	220	226	80	82
RCRA	89	87	83	98	93
CAA	282	189	183	67	65

Our analysis shows that for the 274 CWA cases, the regions were not providing benefit and gravity information for the Quick Look Report in 80 and 82 percent of the cases, respectively. Regarding the 89 RCRA cases, our analysis shows that the regions did not provide benefit component information in 87 cases (98 percent) and gravity component information in 83 cases (93 percent). For the 282 CAA cases, our analysis shows that the regions were not providing benefit and gravity information in 67 and 65 percent of the cases, respectively. The failure to include the information in the Quick Look Report indicates that the amounts may not have been computed.

We also analyzed the information contained in the Quick Look Report by region to determine whether economic benefit and gravity amounts are computed and included in the case information data in all cases by region. The following is the result of our analysis.

Region	Percent Data Were Not Included					
	CWA		RCRA		CAA	
	Benefit	Gravity	Benefit	Gravity	Benefit	Gravity
1	78	78	100	100	83	83
2	53	47	100	100	28	25
3	90	93	100	100	83	70
4	62	75	86	100	56	37
5	91	91	97	87	87	90
6	82	82	100	92	50	50
7	80	80	100	100	56	56
8	85	92	100	100	78	78
9	100	100	100	100	73	73
10	81	81	100	100	50	50

As shown above the problem of not including the economic benefit and gravity amounts in the Quick Look Report is national.

The Quick Look Report is incomplete. Relevant data for tracking each case is, in many instances, missing. This information must be computed, in a timely manner, for each case and included in the data base for management's use and review. It would also serve as a checkpoint to ensure that relevant penalty data is computed.

Enforcement Accomplishments

The Agency annually reports on its enforcement accomplishments. However, the statistics do not capture the effectiveness of EPA's enforcement program as discussed below.

OECM's "FY 1988 Environmental Accomplishments Report" stated that Federal environmental enforcement activity is proceeding at levels unmatched since the Environmental Protection Agency was created in 1970 to enhance the protection of human health and the environment from the risks resulting from environmental pollution. The report further stated that in FY 1988, EPA established new high-watermarks for both Federal civil and criminal judicial enforcement actions with 372 civil cases and 59 criminal cases referred to DOJ. Since FY 1984, EPA has collected \$71.2 million in civil judicial penalties and 39.1 million in administrative penalties. The report further stated that as part of the effort to deter noncompliance, EPA's enforcement programs have developed penalty policies designed to assess penalties which recoup the economic benefit that a noncomplying facility has realized, and assess additional penalties commensurate with the gravity of the violation(s).

The above types of statistics only show the number of referred cases and penalty dollars collected, which demonstrates only a minor measure of program effectiveness. We believe the effectiveness of the Agency's use of penalties depends on the premises associated with the use of this enforcement tool. In order to be an effective deterrent, civil penalties should be large enough to hurt the offender financially. Premises pertinent to enforcement are as follows:

- Penalties are punitive in nature and intent.
- In order to be punitive, penalties must be large enough to punish the wrongdoer and to deter him and others from committing the offense.
- Penalties that do not negate the economic benefits derived from violations of program requirements are not fair to those who comply with the program and do not deter future violations.

The assessment of penalties that are sufficiently burdensome to be a deterrent to future violations is a critical tool in reaching EPA's goals. It must be made clear to the regulated community that the cost of noncompliance will be greater than that of compliance. Penalties should be punitive in nature rather than remedial. Penalties should deter future noncompliance, by both violators and potential violators, and not just bring a violator back into compliance.

A strong and well managed national program on assessment of penalties against violators of EPA regulations needs reliable summary information to judge the success or failure of the program and to identify those critical areas needing immediate management attention. SPMS, a management tool, whose principal clients are the Administrator and Deputy Administrator, is designed to provide a framework for the setting of goals and priorities, the development of annual guidance for program implementation, and for the evaluation of performance in meeting program objectives. Senior managers review SPMS reports to help them determine accomplishments, problem areas and possible corrective actions. Thus, EPA's management controls need to track the statutory penalty, the economic benefit and gravity-based components, the proposed penalty, the assessed penalty, and any reductions to each.

Draft Report Recommendation

We recommended that the OECM Acting Assistant Administrator, coordinate with the Assistant Administrator for the Office of Policy, Planning, and Evaluation (OPPE), and implement a Strategic Planning and Management System (SPMS) reporting requirement to provide for the penalty results of concluded cases by media program. SPMS should show computed penalties, reductions by Agency staff, reductions by Department of Justice and Agency staff, and the final assessed amounts. We recommended also that the Acting Assistant Administrator ensure that the Quick Look Report is complete.

Agency Reply To OIG Draft Report

The Acting Assistant Administrator for OECM disagreed with our recommendation primarily because it would require a significant workload increase. The Assistant Administrator for OPPE agreed partially with our recommendation and stated that they have already initiated discussions with OECM concerning this recommendation. However, OPPE would rather see the management of the OECM functions strengthened and use the specific reporting recommendation as part of OECM's own management of Agency penalty program(s) rather than incorporating such specific details in SPMS.

Auditor's Comments

The information we are asking for is already supposed to be produced via the penalty negotiation process; thus, we do not see a major increase in workload. This data should be accumulated in a fashion so that the effectiveness of the media penalty negotiation process can be better evaluated by senior EPA management. A good start would be to ensure that OECM's Quick Look Report, which already contains various penalty information, is complete. The Quick Look Report could be expanded to increase the other information contained in our draft report recommendation. The expanded and complete Quick Look Report would then contain the accumulated media penalty data, which could very easily be incorporated into SPMS.

Recommendation

We recommend that the OECM Acting Assistant Administrator coordinate with the OPPE Assistant Administrator to assure that Federal penalty results of concluded cases by media programs are accumulated. The data should show computed penalties, reductions by Agency staff, reductions by DOJ and Agency staff, and the final assessed amounts. A decision by appropriate officials can be made at a later date as to whether the data should be made part of SPMS.

SUMMARY OF ISSUED REPORTS

1. "Office of Mobile Sources' Establishment, Mitigation, and Collection of Penalties" (E1G16-05-0058-61560)

The penalties proposed by the Office of Mobile Sources' (OMS) on violators of EPA's unleaded gasoline regulations have not changed since 1975 and may need revision. Proposed penalties are in some cases only 5 to 10 percent of the amount allowed by the Clean Air Act. The effectiveness of EPA's unleaded gasoline regulations and future enforcement efforts against fuel additive violations could be improved by a formal periodic review of the proposed penalty tables to ensure penalties are large enough to encourage compliance. The effects of noncompliance with EPA's unleaded gasoline regulations are significant.

OMS has not finalized its draft February 1985 Civil Penalty Policy for fuel and tampering violations. Each EPA program office, in a joint effort with the Office of Enforcement and Compliance Monitoring (OECM), is to revise existing policies or write new policies to ensure conformance with the Agency's February 1984 Policy on Civil Penalties. However, OMS has not submitted its policy to OECM for review.

If a penalty is to achieve deterrence, both the violator and the general public must be convinced that the penalty places the violator in a worse position than those who have complied in a timely fashion. The penalties used by OMS are over 10 years old. Thus the regulated community has had ample time to comply with EPA's rules. OMS needs to coordinate its draft penalty policy with OECM to assure its enforcement program is consistent with the Agency's Policy on Civil Penalties.

2. "Region 5's Stationary Sources of Air Pollution Compliance and Enforcement Program" (E1K67-05-0449-80743)

The Region and two States were not timely enforcing stationary sources for air pollution violations. The violations occurred in cities which are not meeting National Ambient Air Quality Standards. Consequently, the environment was harmed because significant violations were allowed to continue beyond timeframes

established by EPA. Also, EPA's goal of fair and of equitable treatment of violators was not being achieved. Many of the violators exceeded EPA's target resolution date by over 1 year. Assessment of about \$3.3 million in cash penalties for the cases reviewed was delayed.

Regional officials were not calculating and assessing penalties for stationary source violations of the Clean Air Act. Most collected penalties did not recover the savings the violator received from delayed and/or avoided costs (economic benefit). Further, we found cases with no support as to how the penalty was calculated. We also found cases with substantial unsupported reductions to calculated penalties. Consequently, EPA's goals of deterrence and fair and equitable treatment of violators are not being achieved.

We judgmentally selected 12 of the 18 significant cases that were settled with penalties during fiscal year 1986. We compared the calculated penalty contained in the litigation report to the Agency's civil penalty guidance. Only four litigation reports contained penalty calculations that followed the civil penalty policy. Three of the remaining eight cases had no documentation as to how the penalty was calculated. In one case the penalty calculation did not include an amount for a serious violation component even though the company was in violation for 10 years. The collected penalty, in only two of nine applicable cases, was greater than the economic benefit the company received from not complying with the Clean Air Act. Further, cases were found where the calculated penalty amount was significantly reduced without any documentation.

3. "Consolidated Report on EPA's Administration of the Asbestos National Emission Standard for Hazardous Air Pollutants (NESHAP)" (E1GM7-05-0571-80821)

The Agency needs to enforce NESHAP regulations with greater penalties. The assessment of penalties for violations of NESHAP regulations in the regions was generally inadequate because of a lax attitude toward penalizing violators. Also, State enforcement programs varied in thoroughness, and States were not fully carrying out their delegated responsibilities.

Consequently, the primary purpose of penalties, namely to deter violations of EPA's regulations and to remove any economic benefit resulting from noncompliance, was less likely to be accomplished.

4. "Non-Community Water System Program" (E1HW7-03-0171-81928)

EPA was not enforcing water quality standards aboard interstate carrier conveyances (ICC) (airplanes, trains and buses) serving drinking water to the public. Consequently, passengers traveling on these ICCs were being exposed to unnecessary health risks. Over 650,000 passengers are served on board aircraft daily, many of whom consume drinking water in the form of hot and cold drinks. According to the Safe Drinking Water Act, suppliers of this drinking water must comply with testing and reporting requirements. These requirements are necessary even if the water was obtained from a public water system that has complied with all Federal regulations. The additional testing by the ICCs is essential because the water could become contaminated in transporting or storing the water aboard the facilities.

The four states covered by our review did not (a) issue timely violation notices to the suppliers, (b) obtain evidence of public notification, (c) perform any significant enforcement actions against non-community water systems (NCWS), (d) develop or implement enforcement strategies against NCWS and (e) comply with Federal reporting requirements concerning enforcement actions. Some states were not able to provide statistics for the number of enforcement actions regarding NCWS. We were informed by various personnel that enforcement resources were limited at best and were generally directed at community water systems.

5. "Review of Region 5's National Pollutant Discharge Elimination System Permit Enforcement Program" (E1H2D8-05-0293-9100164)

The Region did not follow the Agency's civil penalty policy in assessing penalties for violations of NPDES permit requirements issued under the Clean Water Act in three of the six cases reviewed. Penalties were substantially reduced with very little documentation to support the reductions. The assessed penalties did not always recover the economic benefit of noncompliance the violators received. A double standard has been

established for industrial and municipal violators, and the standards themselves are not being implemented on a consistent basis. As a result, EPA's goals of deterrence and fair and equitable treatment of violators are not being met.

Six of 11 NPDES cases settled with penalties during FY 1987 were reviewed to determine whether penalties were calculated and assessed in accordance with Agency guidance. Five of the six cases reviewed included documentation to show economic benefit of delayed compliance and to support the recommended penalty. However, the penalties assessed (\$202,500) in three of the five cases were about \$10.9 million less than the economic benefit (\$11,134,000) the violators received by not complying with the Clean Water Act. In addition, the files contained little documentation to justify the substantial reductions.

6. "Report of Region 4's National Pollutant Discharge Elimination System Permit Enforcement Program" (ELHWDS-04-0207-9100462)

Region 4 and the states of Georgia and Alabama were not always effectively enforcing National Pollutant Discharge Elimination System (NPDES) permits. Neither the region nor the two states had adequate enforcement management systems. Regional and state personnel were reluctant to take the necessary enforcement measures needed to prevent and eliminate permit violations. Enforcement actions were not always timely, and actions were not escalated when situations warranted. Financial penalties were not effectively used. As a result, some of the region's most significant and chronic NPDES permit violators avoided the expense of complying with the Clean Water Act with little or no penalty.

Because the region and the states did not effectively enforce NPDES requirements, the statutory goals of Congress and EPA were not fully met in Region 4. Agency Operating Guidance for fiscal year 1988 specifically stated that "a high priority for surface water programs in 1988 is to protect human health and the environment by controlling toxicity in all waters where designated uses are not being attained due to the presence of toxic discharges from either point or nonpoint

sources". Less than aggressive enforcement of the NPDES requirements negatively impacts the Nation's waterways, causing a danger to their aquatic life and limiting their recreational use.

7. "Report on National Pollutant Discharge Elimination System Permit Enforcement Program in Region 2" (E1HW8-02-0133-9100476)

The two states reviewed for this report did not follow the Agency's and/or their own civil administrative policies in assessing penalties for violations of NPDES permits. The review disclosed (a) penalty assessments did not include an economic benefit component for violator noncompliance, recover the States' administrative cost of enforcement, or consider other relevant factors; (b) penalties for previous violations were suspended if violators complied with current Consent Order provisions; (c) penalty assessments were inconsistent for municipal and industrial violators and for similar violations; (d) stipulated penalties were not always included in Orders; and (e) cases files lacked adequate documentation to support original or compromised penalty amounts. These conditions occur because of inadequate or failure to implement existing policies and procedures pertaining to penalty assessments, computations and documentation. As a result, EPA's and the State's goal of fair and equitable treatment of violators was not always being met. In addition, the imposition of penalties did not serve as an effective means for deterring continued violator noncompliance.

8. "Report of Region 9's Administration of the State of Hawaii's Grant Programs for Fiscal Years 1986 through 1988" (E1F58-09-0184-9100446)

Facilities in the State of Hawaii have been able to discharge pollutants into the water and air in violation of requirements without concern that significant enforcement actions would be taken against them. This condition was due to a lack of a serious commitment by the Department of Health (DOH) to establish an effective enforcement program. This weakness was compounded by the fact that the Region had not assumed its responsibility to direct DOH to implement an effective enforcement program, or otherwise taken primary responsibility for enforcement of water and air requirements in the state. Although we noted a number of examples of facilities in the state with long histories of water and air

discharge violations, DOH had not proposed or collected meaningful monetary penalties against them. For example, one air discharger had violated requirements for at least eight years with only a \$500 penalty being proposed during the entire period. Also, for FY 1987, the Region indicated that of the \$276,000 of water pollution penalties proposed by the state, only \$2,000 had been collected. In view of the significance of the violations observed and their duration, it is our opinion that the low penalty rates did not meet the goals of EPA's General Enforcement Policy. The goals of the policy require an enforcement approach that provides a deterrent effect and swift resolution of environmental problems.

Monetary penalties for violations of NPDES permit requirements were generally not proposed by DOH, and violator compliance schedules were often not enforced. As a result, only a fraction of the violations which occurred over the last several years have resulted in a penalty, and many did not result in timely correction of the pollution problem. With respect to penalties, one-third of the 27 Notice of Violations (NOVs) issued by the DOH under the water pollution control program in FY's 1986 and 1987 did not include a proposed penalty. Further, there was no documentation explaining why penalties were not proposed against the violators that received NOVs. However, our review disclosed that many of the NPDES violations reported in the NOVs were repeat violations that had continued over long periods of time.

We concluded that DOH has not enforced air pollution control standards in the State of Hawaii in an effective manner. DOH has generally extended violator compliance schedule due dates, rather than initiate enforcement actions when compliance schedules are not met. Also, when monetary penalties are proposed, they are generally not sufficient to accomplish the goals of EPA's enforcement policies.

9. "Consolidated Report on Review of EPA's Controls Over Administrative Penalties Under the RCRA Enforcement Program" (E1G68-09-0188-9100479)

Regional offices are not, as a general rule, including the value of the economic benefits of noncompliance in proposed and assessed administrative penalties against RCRA violators. As a result violators gain financially from noncompliance with RCRA statutory and regulatory requirements. Of the 20 cases reviewed where it appeared that a value for the economic

benefits of noncompliance should have been assessed, only one case had a final assessed penalty that was sufficient to eliminate the violators economic benefits. To illustrate the potential benefits that can be derived, the violator in one of the cases reviewed had estimated economic benefits of \$229,000 because it did not comply with RCRA requirements. The affected region, however, settled that case with a final assessed penalty of only \$45,000, resulting in a net gain to the violator of \$184,000.

Sufficient gravity-based RCRA penalties are not being consistently proposed to reflect the seriousness, duration of noncompliance, nor all of the violations disclosed. This condition results in penalties inadequate to provide an effective deterrent to noncompliance by the RCRA regulated community. To illustrate, cases were reviewed where groundwater monitoring violations, improper discharges of hazardous waste, and other significant RCRA violations occurred for periods of up to three years, resulting in proposed gravity-based penalties as small as \$6,500. In one case, the proposed gravity-based penalty amounted to \$29 per day for 34 months of noncompliance and in another case only \$11 per day for a six month period of noncompliance. These conditions were largely attributable to the regions either not considering lengthy periods of noncompliance in computing gravity-based penalties or not proposing penalties for all distinguishable violations, as required by the RCRA penalty policy.

Regional negotiators are mitigating RCRA penalties in excess of the parameters contained in existing Agency policy. Final negotiated RCRA administrative penalties, for cases settled during the period reviewed ranged from an average of 14 to 67 percent of proposed penalties with a national average of only 37 percent. Cases reviewed included penalty reductions of as much as \$2 million and reductions for individual violations ranged up to 100 percent. Excessive reductions of penalties diminish the deterrent effects of the enforcement program on the regulated community. Reduced fines can also undermine EPA's efforts to return significant noncompliers to compliance. In effect, achievement of the Agency's penalty policy goals, deterrence and fair and equitable treatment of the regulated community, is questionable.

Regional offices are not documenting the proposed penalty calculations or the specific negotiated adjustments to proposed penalties, or including a statement in the executed consent agreements of the

reasons for mitigating the penalties. Of the 20 cases reviewed, 19 cases had at least one of these two conditions. In some instances, significant reductions in penalties were made without documentation explaining or justifying the reduction. To illustrate, one case had a proposed penalty that was \$6.3 million less than the recommended maximum penalty calculated by the region's enforcement personnel. However, there were no regional records explaining or justifying the difference. We attribute the lack of documentation as required by the RCRA penalty policy, in part, to regional concerns that the availability of detailed information on penalty adjustments could jeopardize future negotiations. The RCRA penalty policy requires such documentation as one of the controls to assist in precluding excessive or improper penalty mitigations without regional management's full understanding. Such documentation also increases the assurance that the regulated community is being fairly and equitably treated.

10. GAO Report--Hazardous Waste...Many Enforcement Actions Do Not Meet EPA Standards (GAO/RCED-88-140)

Penalties assessed by EPA and the states against violators of RCRA requirements may not be large enough to offset the economic benefits of noncompliance. According to the Enforcement Response Policy, the EPA regions are required to follow guidelines contained in RCRA Civil Penalty Policy (RCPP) when assessing penalties against violators of RCRA regulatory requirements. The RCPP was issued in May 1984 to ensure that RCRA penalties are equitably applied and provide an adequate deterrent to noncompliance. The policy provides that, with four exceptions, a penalty should be large enough to remove the economic benefits waste handlers might gain by not complying with RCRA requirements. The Enforcement Response Policy, however, does not require the states to use the RCPP when calculating penalties. State penalty policies were not uniform in how they consider the economic benefit of noncompliance in penalty calculations and that existing EPA and state policies and procedures for calculating penalties were not being properly documented.

Consequently, there was no assurance that EPA and state penalty policies are being properly implemented and that the economic benefit of noncompliance is being adequately calculated and included in the final penalty assessment. As a result, final penalty assessments may not be large enough to offset the economic benefit of noncompliance and thus deter future noncompliance in the regulated community.

In general, GAO could not determine whether the EPA regions issued penalties as prescribed by the RCPP because of the lack of documentation in the files. The regions reviewed issued proposed penalties in 40 of the high-priority enforcement cases included in the review. GAO reviewed 31 of these penalties and found only 2 cases in which they could verify that the economic benefit was calculated in accordance with RCPP.

In nine cases GAO found that conditions related to one of the four exceptions applied, and thus there was no need to include the economic benefit in the proposed penalty. However, GAO found no documentation supporting these determinations. In 15 cases GAO reviewed the penalty calculations, but did not find sufficient evidence or documentation to show that the economic benefit of noncompliance had been considered in the penalty calculation. For the remaining five cases, GAO found no documentation on penalty calculations to review. Thus, in these 29 cases GAO was unable to determine whether the proposed penalties adequately considered the economic benefit of noncompliance.

11. GAO Report--Inland Oil Spills...Stronger Regulation and Enforcement Needed to Avoid Future Incidents (GAO/RCED-89-65)

In the absence of national guidance on the imposition of fines for violations of EPA's Oil Pollution Prevention regulations, the regional offices have adopted inconsistent policies. Overall, fines are rarely used, although EPA's data indicate that the rate of noncompliance with the regulations may be high.

CASE SUMMARY EXAMPLESClean Water Act Cases

1. A company was discharging untreated process wastewater directly into a nearby river and to a publicly-owned treatment works through the sanitary sewer system. The company did not have a NPDES permit to discharge into the river. State authorities estimated that the company was continuously discharging into the river since 1976. The company was also not authorized to discharge into the sanitary sewer. The company completed construction of a connection to the sanitary sewer in March 1980. The company had stated that it was discharging only sanitary waste, instead of untreated process water.

In June 1983, the region requested that the state initiate enforcement action. When the state did not take action, the region referred the case for civil action on August 5, 1983. The region initially calculated an economic benefit of \$839,852 and a gravity-based penalty component for recalcitrance of \$900,000. However, these amounts were reduced to a recommended penalty of \$100,000 due to the company's inability to pay. A consent decree was signed on November 23, 1986, and included a \$100,000 penalty. The company complied with the provisions of the consent decree, but the assessed penalty of \$100,000 had not been paid at the time of our audit. (EPA Audit Report No. E1H2D8-05-0293-9100164)

2. A company operates a manufacturing plant which discharged, on a daily basis, between 50,000 and 200,000 gallons of waste water into the river. Between January 1983 and January 1985, the company violated its NPDES permit limits for various common effluents and also dangerous substances, such as cyanide and copper.

The company had a history of noncompliance. The state environmental authority issued a compliance order in 1979 to the company for similar violations. The order included a \$2,500 penalty. The state also issued a new permit to the company with less stringent effluent limits. The company continued to violate its new permit and compliance order. The state requested that the region take enforcement action since further administrative action would not be sufficient to obtain compliance.

The region referred the case for civil action, seeking a civil penalty of \$150,000, on June 27, 1985. The proposed penalty did not even cover the calculated economic benefit of \$183,000. The Consent Agreement/Final Order (CA/FO) included a penalty of \$137,500. The company has, to date, substantially complied with the CA/FO. (EPA Audit Report No. E1H2D8-05-0293-9100164)

3. The region proposed a \$7,332,000 penalty for the city. The amount included \$1,222,000 for the recalcitrance factor because of the permittee's failure to develop a definite compliance plan "after much prompting from EPA". The city had continually violated its permit conditions. The region initiated a civil referral in September 1987 when it was evident the facility was not going to meet the July 1, 1988 compliance deadline. In addition to the \$1.2 million for recalcitrance, the civil referral showed an economic benefit of \$5,845,000 because of the 84-month delay in compliance and a gravity component of \$265,000. The region computed a settlement penalty of \$733,200. The region adjusted the original \$7 million downward by 10 percent for the city's inability to pay and 80 percent for litigation considerations (an assumption the government would save time and expense by quickly settling). (EPA Audit Report No. E1HWDS-04-0207-9100462)

Resource Conservation and Recovery Act Cases

1. The regional negotiators mitigated the proposed penalty of \$77,630 down to \$7,500, or a reduction of over 90 percent. The region's complaint against the company included the following counts and proposed penalties:

- a. Failure to characterize on-site waste, \$9,000;
- b. Accumulating waste on-site for longer than 90 days;
- c. Failure to demonstrate adequate liability insurance coverage, \$22,500; and
- d. Failure to make timely payments to the financial assurance trust fund, \$37,130.

Documentation in the region's enforcement files indicated that the company had been violating the RCRA regulations cited in the complaint for a period of three to five years.

The company's response to the complaint attempted to justify reasons why the facility should not comply instead of taking positive actions to bring the facility into compliance. In our opinion, the company clearly exhibited a reluctance to comply as well as a substantial history of noncompliance.

Regional negotiators, in settling the case, adjusted the proposed penalties down to \$7,500. Counts (1), (2), (4), with proposed penalties totaling \$55,130, were reduced to \$0. Count (3), with a proposed penalty of \$22,500, was reduced 67 percent to \$7,500. In our discussions with regional negotiators, they provided the following reasons for the penalty reductions:

- a. Past cooperation and future corrective actions to be done by the company;
- b. The company assertions that it had characterized the waste and had a manifest for transporting the waste;
- c. Questionable applicability of regulations because the company asserted it was a recycling and reprocessing facility;
- d. Conflicting information told by regional inspectors on whether the company was regulated or not;
- e. Avoidance of a complicated trial; and
- f. The company just didn't want to pay the penalties.

Documentation in the region's case files did not provide support for several of the above reasons. We found no evidence that the company had made efforts to correct violations independently of the region's enforcement/inspections. The violator seemed to have ignored the region's prior attempts at encouraging RCRA compliance. We found no evidence to substantiate the performance of waste characterization, that the wastes were not hazardous, or that the shipments had been manifested. The problem with conflicting information being given to the facility by permitting personnel versus enforcement personnel, in our opinion, is not a valid basis for excessively reducing penalties. The region's 90 percent reduction of the proposed penalties appears to have exceeded the guidelines contained in the RCPP and were not justified based on available documentation. (Draft Audit Report No. E1G68-09-0188)

2. The regional negotiators adjusted the proposed penalty of \$550,000 (\$525,00 for not manifesting and \$25,000 for illegal discharges) down to \$45,000, or a 92 percent adjustment. The region's explanation for reducing the penalty was that the case evidence was inadequate to prove that all 85,000 gallons of wastes disposed of were hazardous. According to the penalty policies, the burden of proof rests with the violator. Thus, once cited, the company should have had to prove that all 85,000 gallons of waste were not hazardous.

The region had laboratory results from one grab sample which showed the hazardous waste characteristics of the company sample. The EPA inspector indicated that the sample was representative of the company's waste stream. The inspector also found that the company disposed of hazardous wastes for 21 days without the required RCRA manifests, which would be an egregious violation. Regional records also showed that, just prior to the subject infractions, the company violated similar hazardous waste regulations by failing to analyze generated solid wastes for hazardous characteristics and failing to prepare hazardous waste manifests. This was documented in a complaint issued against the company in June 1983. A CA/FO was executed with the company on August 29, 1983, in which the company agreed to comply with the RCRA generator regulations and submit waste analyses to the regional office. However, the company continued to violate the RCRA regulations while the terms of the previous CA/FO were still in effect. Thus, the evidence showed the company to be a repeat violator of RCRA and to have improperly disposed of hazardous waste for 21 days.

The company, in response to the complaint, did not present sufficient evidence to show that any of the generated wastes were not hazardous. The company's behavior could be described as concealment and compliance avoidance with program regulations. We believe that the Region had a preponderance of evidence that strongly supported the proposed penalties. Regional personnel claimed, however, that the region's evidence would not hold up before an Administrative Law Judge hearing. In our opinion, this conclusion was speculative and an inadequate basis to reduce the proposed penalty so extensively.

The \$45,000 final assessed penalty appeared to be an arbitrary settlement for both violations cited in the complaint. With regard to the mitigation of the \$25,000 improper disposal penalty for the second violation, no

documentation was found to support the region's mitigation of this penalty. We found no justification to reduce the proposed penalties by more than \$210,000 in total. The region, however, reduced the proposed penalties by a total of \$505,000. (Draft Audit Report No. E1G68-09-0188)

Clean Air Act (CAA) Cases

Stationary Sources

1. A company accrued economic benefits of \$900,000 over a two and one-half year period of violations, but the region reduced the amount to \$14,000 because the company exceeded its emission standard for only 15 days during this time. Even though there were only 15 days of violation, the company saved \$900,000 by delaying the installation of the pollution control equipment.

The region stated that the company did not continuously violate the CAA and the civil penalty policy assumes continuous violation of the statute is necessary. It is of little consequence that the violations were on occasions or on a continuous basis, the economic benefit from delayed investment in pollution control equipment is the same. EPA's policy is to recover the savings the violator received from delayed and avoided costs. The CAA authorizes EPA to assess penalties of up to \$25,000 per day per violation for noncompliance with program requirements; in this case \$375,000 (15 days times \$25,000 per day). There should have been a higher collection for the economic benefits in this case. (EPA Audit Report No. E1K67-05-0449-80743)

2. A region investigated and documented numerous complaints and violations at a facility engaged in open air sandblasting operations. This activity led to improper emissions affecting adjoining property owners.

The region issued a notice of violation in July 1985 and an administrative order in October 1985. The administrative order required the company to take substantive control measures by erecting barriers or enclosing those areas in which sandblasting was done to prevent further violations. In August 1986 the region referred the case to the Department of Justice (DOJ) for prosecution. A proposed civil penalty of \$60,791 was sought. The proposed penalty included amounts for failure to take prompt corrective action and a history of recalcitrance in complying with the administrative order. The region established a proposed bottom line figure of \$20,000 for inability to pay.

During negotiations, four additional complaints were lodged against the company for open-air sandblasting. The region and DOJ offered to settle the case for \$33,701 with credits totaling \$28,701 for cooperativeness and agreement to proposed stipulated penalties in the CA/FO. The case was settled for a total penalty assessment of only \$5,000.

The CA/FO required the company to construct enclosures for its sandblasting operation by April 1, 1989. These enclosures had not been built as of April 1, 1989. Inspections by regional officials have documented other violations of the CA/FO. These documents support the company's recalcitrance actions and apparent disregard for the terms of the CA/FO. The company has for three years violated the CAA without significant or apparent corrective compliance action and has paid only minor penalties of \$5,000 for these violations. (Example from expanded audit fieldwork.)

Asbestos National Emission Standard for Hazardous Air Pollutants (NESHAP)

1. A region was notified of demolition work on buildings containing asbestos. The contractor was aware that all work was to be performed in accordance with the asbestos NESHAP demolition and renovation regulations.

The region conducted an inspection of the site and found dry asbestos in a torn container and on the ground, indicating that the material had not been adequately wetted during removal.

The region initiated proceedings against the contractor and proposed a penalty of \$39,279. The penalty included a 100% upward adjustment to the gravity component for recalcitrance in violating the regulations in the first instance and in continuing to violate them after inspectors discussed the initial violation with company representatives. The region settled for \$1,500, based upon the contractor's alleged inability to pay the proposed penalty. Regional case files did not contain documentation supporting the financial inability to pay, nor did the files show that delayed penalty payments were considered in lieu of a straight deduction. (Example from expanded audit fieldwork.)

EXHIBIT 3
(See Page 30)

QUICK LOOK REPORT CONSOLIDATED SOCIET ENFORCEMENT SYSTEM I ALL SENSITIVE DATA - EPA INTERNAL USE ONLY as ALL CASES WITH REFERRALS TO DOJ FROM 03/01/86 TO PRESENT SORTED BY HEADQUARTER DIVIS ON AND LAM (19500)									
LAM	SECTION	TYPE	CIV	BENEFIT	CRIMINAL	PROPOSED	ASSESSED	CIV	
			TO DOJ	COMPONENT	COMPONENT	PEANITY	PEANITY	FILED	DESCRIPTION
CMA	301A	CIV	7/19/86			95,000	27,500	CONCLUDED	
CMA	301	CIV	8/12/86			140,000	40,000	CONCLUDED	
CMA	309								
CMA	301A	CIV	8/01/86			140,000		FILED IN C	
CMA	301B								
CMA	307A								
CMA	307B								
CMA	307A								
CMA	307	CIV	8/02/86			60,000		CASE CLOSE	
CMA	301	CIV	11/04/86					FILED IN C	
CMA	307								
CMA	309								
CMA	402								
CMA	309B	CIV	2/16/87			240,000	150,000	CONCLUDED	
CMA	309C								
CMA	301	CIV	3/31/87	800,000	800,000	300,000		FILED IN C	
CMA	309								
CMA	402								
CMA	301	CIV	4/27/87			63,000	31,500	FILED IN C	
CMA	301								
CMA	301	CIV	5/12/87	120,000	120,000			FILED IN C	
CMA	307								
CMA	309								
CMA	402								
CMA	301	CIV	11/13/87			85,000		FILED IN C	
CMA	402								
CMA	301	CIV	8/13/88			75,000		FILED IN C	
CMA	402								
CMA	309	CIV	3/28/88			115,000		FILED IN C	
CMA	308								
CMA	301A	PRN	5/27/88	11,530,000	100,000			CASE CLOSE	
CMA	301	PRN	4/25/88	3,807,000	350,000			AT DOJ	
CMA	301A	CIV	7/07/88					AT DOJ	
CMA	402								
CMA	301	CIV	8/16/88			100,000		AT DOJ	
CMA	402								
CMA	301	CIV	9/30/88					AT DOJ	
CMA	402								
CMA	301	CIV	9/30/88					AT DOJ	
CMA	309								
CMA	402								

EXHIBIT 4
(See Page 30)

QUICK LOOK REPORT
CONSOLIDATED DOCKET IMPROVEMENT SYSTEM
** SENSITIVE DATA - EPA INTERNAL USE ONLY **
ALL CASES WITH REFERENCE TO DOJ FROM 8/31/84 TO PRESENT
NOTED BY REAGAN/WHITE DIVISION AND LAW (200J)

[illegible]

EXHIBIT 5
(See Page 30)

QUICK LOOK REPORT											
CONSOLIDATED DOCKET ENFORCEMENT SYSTEM											
** SENSITIVE DATA - EPA INTERNAL USE ONLY **											
ALL CASES MUST BE OPENED BY 06/01/86 TO PRESENT											
SORTED BY HEADQUARTER DIVISION AND LAW TYPE											
LAW	SECTION	CASE	TYPE	CIV	TO DOJ	BENEFIT	COMPONENT	GRAVITY	COMPONENT	PROPOSED	ASSISTED
										PENALTY	FEDERAL
											STATUS
											DESCRIPTION
CAA	112		CIV	6/25/88		1,600		10,000		11,600	AT DOJ
CAA	110		CIV	6/24/88						461,183	AT DOJ
CAA	111										
CAA	112		CIV	6/30/88		11,025		21,000		32,025	AT DOJ
CAA	112		CIV	6/30/88		1,053		14,000		15,053	AT DOJ
CAA	112		CIV	6/28/88		2,614,000		811,000		3,325,000	AT DOJ
CAA	110										
CAA	111		CIV	8/31/88		32,372		44,000		85,172	AT DOJ
CAA	111		CIV	9/18/88		11,486		156,000		167,486	AT DOJ
CAA	111		CIV	9/18/88		25,000		25,000		120,000	AT DOJ
CAA	111		CIV	9/30/88							AT DOJ
CAA	112		CIV	9/16/88		1,800		17,000		18,800	CONCLUDED
CAA	112		CIV	7/12/88						10,100	FILED IN E
CAA	112		CIV	7/18/88		9,279		38,288		47,567	CONCLUDED
CAA	110		CIV	6/19/88		2,781		34,000		40,781	CONCLUDED
CAA	111		CIV	9/03/88		63,081		55,000		118,081	CONCLUDED
CAA	112		CIV	4/16/87		5,174		5,888		110,051	CONCLUDED
CAA	112		CIV	10/16/87							CONCLUDED
CAA	112		CIV	2/17/87		7,000		16,500		19,437	FILED IN E
CAA	112		CIV	5/05/87		3,627		16,000		17,627	FILED IN E
CAA	111		PRM	6/31/87						17,528	CONCLUDED
CAA	114		CIV	9/11/87						110,000	FILED IN C
CAA	114		CIV	9/15/87						85,500	FILED IN C
CAA	110		CIV	6/02/88						659,000	AT DOJ
CAA	112		CIV	9/30/87		54,307		30,000		60,307	FILED IN E
CAA	112		PRM	5/17/88						75,592	FILED IN E
CAA	112		PRM	2/01/88						12,950	FILED IN E
CAA	112		PRM	5/16/88						11,200	FILED IN E
CAA	112		PRM	4/16/88						10,000	FILED IN E
CAA	107		CIV	3/28/88				20,000		216,783	FILED IN C
CAA	111		CIV	6/24/88		17,032				340,000	FILED IN C
CAA	112		CIV	9/17/87						42,000	FILED IN C
CAA	112		CIV	9/19/87						345,500	FILED IN C
CAA	112		PRM	12/16/87						319,000	FILED IN C
CAA	112		CIV	9/19/88						16,540,000	FILED IN C
CAA	111		CIV	9/10/88						60,000	FILED IN C
CAA	110		PRM	9/20/88						49,000	CONCLUDED
CAA	110		CIV	3/21/88		55,024		43,000		60,000	CONCLUDED
CAA	110		CIV	3/31/88		3,393		35,000		48,393	CONCLUDED



APPENDIX 1
UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

AUG 31 1989

9-5
08-1307

OFFICE OF ENFORCEMENT
AND COMPLIANCE
MONITORING

MEMORANDUM

SUBJECT: Comments on Draft Audit Report
No. E1GBE9-05-0087-91***** "Capping Report on the
Computation, Negotiation, Mitigation and Assessment
of Penalties Under EPA Programs

FROM: Edward E. Reich *EE Reich*
Acting Assistant Administrator

TO: Ernest E. Bradley
Assistant Inspector General for Audit

Thank you for the opportunity to comment on this draft report. My staff has reviewed it and their comments are reflected in this memorandum. In addition to the following general comments, I am including media specific comments unique to TSCA and FIFRA as well as a 'pen and ink' mark-up of your report.

I agree with your first recommendation concerning the need for the Office of Enforcement and Compliance Monitoring (OECM) and media program Assistant Administrators to reemphasize to Agency personnel the need to adhere fully to media program penalty policies. I also agree with the recommendation for more aggressive oversight of Regional activities. I believe this can best be accomplished through expanding the existing media program oversight audits conducted periodically by each program office with OECM's participation. These program office reviews can be expanded and modified to assess the adequacy of penalty computations under applicable program penalty policies. It needs to be made clear, however, that Headquarters resources will not permit review of each penalty nor do we agree that this would necessarily be an appropriate use of resources. Oversight activities should include assuring that regions have in place and are implementing adequate systems for tracking and documenting penalty assessments and for

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assuring adherence to the guidelines spelled out in our penalty policies. While your recommendation includes the Department of Justice (DOJ), I cannot commit them to providing documentation for reductions made in the course of negotiations with violators. We do intend, however, to discuss with DOJ the need for appropriate documentation of the rationale for final penalties in judicial cases.

The report also finds "[a]ppropriate penalties were either not calculated and assessed at all, or inadequately calculated," and "[t]he Agency, in assessing penalties, had not complied with either the letter or intent of the various penalty policies in all cases." Since none of the case examples described have any citation or identification, we were unable to address them specifically. The report found that the economic benefit and gravity components were not indicated on the Quick Look Report and asserts that "failure to include the information in the Quick Look Report indicates that the amounts may not have been computed." Relying on the Quick Look Report to reach this conclusion, however, shows a serious misunderstanding of how the docket system is used in relation to penalty calculations.

Because we do not rely primarily on the docket system to keep track of penalty calculations, no special emphasis is placed on maintaining those particular data fields. The docket mainly functions to keep track of the number of cases currently in the system, the government attorneys assigned to them, which provisions of the various statutes were violated, and other matters. There are more specific and effective procedures in place for keeping track of penalties of which you may not be aware.

Headquarters requires in its Civil Penalty Policy that all litigation reports contain penalty calculations which support the proposed minimum settlement amount. Further, all regional case files must contain documentation of the reasons for any changes in the proposed settlement amount from the time the case is initiated until a consent decree is signed. In addition, Headquarters approval of all minimum settlement amounts is required.

A Headquarters enforcement staff attorney is assigned to every civil judicial case. One of their primary functions is to monitor regional compliance with these procedures and the penalty policy. Therefore, there is case-by-case monitoring by Headquarters of regional compliance with the penalty policy in civil judicial cases.

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Relative to State penalties, it is true that under the Agency's "timely and appropriate enforcement response" criteria, EPA can and does take independent enforcement action if a State fails to assess any penalty (or assesses one which is "grossly deficient") for violations for which program policy requires penalties to be assessed. The 1986 Revised Policy Framework on the State/Federal Enforcement Relationship requires States to keep sufficient documentation so that the Regions can determine whether an appropriate penalty was assessed.

In making this determination, EPA considers the State's own penalty authority and any applicable penalty policy. It should be noted, however, that while States are required to have adequate penalty authorities, (but not the same procedures as EPA), they are not required to assess the same penalty for a particular violation as would EPA. Agency policy is very clear on this point. However, EPA has been working with the States to increase their penalty assessments by reviewing specific cases through the oversight process, providing information on penalties which EPA assesses, providing training on EPA's computer program to compute the economic benefit of noncompliance, encouraging them to develop their own formal penalty policies, and providing information through the publication of a summary of the environmental penalty authority of all States.

Your recommendation that the Strategic Planning and Management System (SPMS) show computed penalties, reductions by Agency staff, reductions by DOJ and Agency staff and the final assessed amounts would result in a significant workload increase. In addition, there is tremendous opposition within the Agency to expanding the scope of our accountability system. The management emphasis is gradually shifting toward measures of real program effectiveness, not simply numerical activity indicators. I believe that the expanded program reviews discussed above would provide a preferable approach to oversight, striking a balance between available resources, needed penalty oversight, and measuring real environmental achievements.

We agree that the "Negotiation Skills Training" has been a very successful course. Your statement on page 23 of the report, however, noting that "[t]he course was last provided in FY 1987. . . ." is incorrect. The course was offered six times in FY 1988 and, so far, has been given seven times in FY 1989. OECM will review the implications of making this training, or its equivalent, mandatory for those attorneys engaged in enforcement negotiations. In addition, training on the BEN and ABEL computer models has been given twelve times since August of 1988, ten times in regional offices and twice at Headquarters. The models have also been presented in two States. We intend to continue to support such training.

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I appreciate the opportunity to review this draft report and I hope you find these comments helpful. Should you desire clarification or additional information on any point please contact Pat Alberico of my staff on 382-4540.

Attachments

ATTACHMENT

Pesticides and Toxic Substances Enforcement

On page 19 of your report you note that although no detailed analysis was performed on penalties assessed under the Toxic Substances Control Act (TSCA) or the Federal Insecticide, Fungicide and Rodenticide Act (FIFRA), the aggregate penalties for these programs in FY 87 were reduced, on average, by 82% in TSCA and by 77% in FIFRA. You recommended that OECM evaluate a sample of these cases to determine if problems exist with negotiations. Within the relatively short time to review this, OECM has evaluated these statistics with the Office of Pesticides and Toxic Substance's Office of Compliance Monitoring and has reached the following conclusions.

In the TSCA Program, a large percentage (over 50%) of the 741 cases settled during FY 87, involved violations of the Asbestos In Schools regulations, 40CFR 763 et seq. Because the regulated community consists entirely of public and private educational institutions, the Agency penalty policy recommended that the penalties be substantially mitigated or even fully abated if the school undertook asbestos abatement actions, which were not required under TSCA or the Part 763 rules. This approach was adopted by the Congress when it passed the Asbestos Hazard Emergency Response Act (AHERA) or TSCA Title II in 1987, to replace the Part 763 rule. Penalties under AHERA, by law, must be remitted for educational institutions or paid into an Asbestos Abatement Trust Fund which can be used by educational institutions for additional abatement.

TSCA penalties must be reduced by statute, whenever they may substantially affect a facility's "ability to continue in business" or if there is a financial condition which prevents their ability to pay the fine from cash reserves. These provisions are found in TSCA Section 15. Before EPA will consider reducing a penalty based upon ability to pay, EPA enforcement offices are instructed to obtain credible financial information, such as tax returns, corporate balance sheets or other similar financial documentation.

Finally, TSCA penalties have been reduced in settlement to obtain leverage for environmentally beneficial expenditures as a condition of settlement. Generally, "settlements with conditions" involve the implementation of compliance or abatement activities which are unrelated to correcting the violation that is the subject of the enforcement action (that is a cost that can not be used to reduce the penalty) or implementation

- 2 -

of a compliance audit. An example of a penalty mitigation project might involve the accelerated removal and disposal of PCB electrical equipment. A dollar for dollar credit is not given. Some offices have given a \$1.00 dollar reduction for each \$3.00 dollars spent up to a maximum penalty reduction. With the increased emphasis in EPA on "pollution prevention", it is anticipated that a greater number of cases may be settled with conditions like these and care must be taken to insure that adequate documentation is maintained in the official file and that certification of completion is submitted and verified to ensure that settlement terms are met.

To insure that penalty reductions are appropriately documented, the TSCA Civil Penalty Policy published at 45 F.R. 24358 September 10, 1980, requires that the published work sheet be completed to document each penalty reduction.

In the FIFRA program, a civil penalty matrix and categories of violations was published in the Federal Register in 1974. This guidance provides that the civil penalty to be imposed must take into account the size of the violator's business. EPA must then impose a graduated penalty based upon 5 category sizes of business, the largest category being over \$1,000,000 in gross sales. EPA Regional offices endeavor to place the violator into the appropriate category through reliance on the most readily accessible data, which are Dun and Bradstreet financial reports. Often, however, at settlement conferences, FIFRA violators are able to demonstrate through actual tax returns or accounting statements that the Dun and Bradstreet reports which are advisory and not based on actual certified tax returns are inflated. Under FIFRA, by statute, EPA is precluded from asking for tax returns or financial or sales data at the time of inspection.

FIFRA penalties may also be reduced for factors similar to TSCA; settlements with conditions or abatement activity, although to a much lesser degree. Finally, a significant factor in many FIFRA reduction concerns that type of violation actually involved. The more hazardous misuse of pesticides violation, by statute, are to be handled by the state lead agencies, leaving Federal enforcement efforts to concentrate on violations of misbranding (i.e. false labels or false claims) or failure to submit annual production reports under FIFRA. In a large proportion of these cases, perhaps 35%, failure to file production reports occurs in either very marginal businesses or businesses which are about to, or have, ceased operations. In these cases, very minor fines may be collected along with terminations or surrender of the Registrant's FIFRA establishment number.



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

SEP 1 1988

OFFICE OF
POLICY, PLANNING AND EVALUATION

MEMORANDUM

SUBJECT: Draft Audit Report No. E1GBE9-05-0087-91***** Capping Report on the Computation, Negotiation, Mitigation, and Assessment of Penalties Under EPA Program

FROM: Terry Davies, ¹⁰Assistant Administrator
Office of Policy, Planning, and Evaluation

TO: Assistant Inspector General for Audit

The following is in response to your request for comments on the subject draft audit report. Our response is directed at Finding No. 2- PENALTY INFORMATION NEEDS TO BE PART OF EPA'S STRATEGIC PLANNING AND MANAGEMENT SYSTEM REPORT, pages 27 - 30 of the draft audit report.

We understand that the recommendation suggests that detailed operational information should be included in the Agency's Strategic Planning and Management System (SPMS) concerning the Office of Enforcement and Compliance Monitoring (OECM) and their management of "...computation, negotiation, mitigation, and assessment of penalties under EPA programs."

We agree partially with the recommendation in the draft report in that SPMS should include measures that reflect agency program and management performance of various functions including penalty assessment. We have already initiated discussions with OECM concerning this recommendation.

However, we would rather see the management of the OECM functions strengthened and use the specific reporting recommendation as part of their own management of agency penalty program(s) rather than incorporating such specific details in the agency-wide Strategic Planning and Management System (SPMS).

We believe that such specific information, such as: "...computed penalties, reductions by Agency staff, reductions by Department of Justice and Agency staff, and the final assessed amounts" should not be included in SPMS. Rather indicators of performance by OECM in these and other related management areas should be developed and included in SPMS.

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The Accountability Systems Branch in the Office of Policy, Planning and Evaluation (OPPE) will continue these initial discussions with OECM and address the larger issues concerning availability of data from States and Regions, feasibility of collecting and reporting such data, and whether such data is appropriate for inclusion in SPMS.

With regard to the inclusion of economic benefits components in assessing penalties, the Office of Policy Analysis has developed the benefit of noncompliance (BEN) model which can be used to calculate these benefits. The report did not provide much detail on why economic benefits components are or are not being included in penalty assessments. If there is a need to advise the Regions on how to calculate economic benefit or to follow-up on the use of the BEN model, please contact Bill Painter (382-2756).

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